

NOVEMBER 2021



# THEMATIC REVIEW REPORT

## TARGETED FINANCIAL SANCTIONS AND TRADE BASED MONEY LAUNDERING

CENTRAL BANK OF THE UNITED ARAB EMIRATES

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## ACRONYMS

CBUAE	Central Bank of the United Arab Emirates
TFS	Targeted Financial Sanctions
TBML	Trade Based Money Laundering
PF	Proliferation Financing
LFIs	Licensed Financial Institutions
AMLDD	Anti-Money Laundering Department
ML	Money Laundering
TF	Terrorism Financing
AMLCFT	Anti-Money Laundering and Counter Financing Terrorism
BOD	Board of Directors
DUGs	Dual Usage Goods
FATF	Financial Action Task Force
KYC	Know Your Customer
BOD & Senior Management	Board of Directors, Owners of Exchange Houses, CEO and its direct reports



## BACKGROUND

The Central Bank of the UAE (“CBUAE”) Anti Money Laundering and Combating the Financing of Terrorism Department’s (“AML/D”) risk-based approach and methodology includes the assessment of its licensed financial institution’s (“LFI”) money laundering/terrorist financing (“ML/TF”) risk profile through the collection and analysis of ML/TF risk indicators measuring threats and vulnerabilities.

The AML/D assessed its LFIs’ exposure to ML/TF risks on a thematic basis, focusing on key ML/TF threats and vulnerabilities derived from the risks outlined in Financial Action Task Force’s (“FATF”) 40 Recommendations, the UAE’s National Risk Assessment (“NRA”) and Topical Risk Assessments.

From AML/D’s AML/CFT Data Collection Survey conducted in 2020, it identified Targeted Financial Sanctions (“TFS”) to be one of the critical areas of focus for the **Banking, Finance Companies and Exchange House sector** and Trade Based Money Laundering (“TBML”) as a critical area of focus for the **Banking and Exchange House sector only**.



## PREFACE

This report sets out the key findings from a thematic review conducted by the CBUAE in November 2021.

The review is one of the key deliverables for the CBUAE considering its mandate of supervising the ML/TF and PF risks in the sector. The purpose of this review is to highlight the generic findings observed within the selected LFIs and provide targeted feedback to the sector.

It is important to note that the effectiveness of LFIs controls related to TFS and TBML were not part of this thematic review undertaken by the CBUAE. The review focused on the availability and design of the controls implemented by the financial sector supervised by the CBUAE.



## APPLICABLE LAWS

1. Federal Decree No. 26 of 2021 on Anti-Money Laundering and Combating the Financing of Terrorism and Financing of Illegal Organizations;
2. Federal Decree Law No. (20) of 2018 on Anti-Money Laundering and Combating the Financing of Terrorism and Financing of Illegal Organizations;
3. Cabinet Decision No. (10) of 2019 concerning the Implementing Regulation of Decree Law No. (20) of 2018 on Anti-Money Laundering and Combating the Financing of Terrorism and Financing of Illegal Organizations;
4. The Central Bank of UAE Anti-Money Laundering and Combating the Financing of Terrorism and Illegal Organizations Guidelines for Financial Institutions (Notice 3090/2021);
5. Cabinet Decision No. (74) of 2020 regarding Terrorism Lists Regulation and Implementation of UN Security Council Resolutions on the Suppression and Combatting of Terrorism, Terrorist Financing, Countering the Proliferation of Weapons of Mass Destruction and its Financing and Relevant Resolutions;
6. Federal Law No. (13) of 2007 related to Commodities subjected to import and export control;
7. Cabinet Resolution 50 of 2020 concerning the control list annexed to Federal Law 13 of 2007 related to Commodities subjected to import and export control; and
8. All relevant Guidance issued by the CBUAE.



## SCOPE

The review included limited number of LFI (Banks, Exchange Houses and Finance Companies) from across the sector and focused on their policies, procedures and processes to evaluate how these documents address emerging risks from TFS and TBML.

### **Targeted financial sanctions (“TFS”) related to terrorist financing (“TF”) and proliferation financing (“PF”):**

The UAE’s geographic location and role as an international trading and logistical hub makes its financial system susceptible to abuse by terrorist groups, those financing terrorism, and the proliferation of weapons of mass destruction, therefore assessment of sanctions screening and asset freezing processes at LFIs remains an important priority for AML/CFT supervisors.

To understand this risk, the control assessment questions relevant to this risk theme were circulated to 17 LFIs, based on an inherent risk score calculated for this focused area, taking an equally weighted average of specific Key Data Elements (relevant to TFS). The inherent risk score was calculated based on the data provided in the AML/CFT Data Collection Survey.

### **Trade-based money laundering (“TBML”):**

The high volume of trade and trade-related transactions flowing through the UAE exposes the jurisdiction to TBML risks, whereby the proceeds of domestic and foreign crimes are laundered through the UAE under the pretense of legitimate trade. TBML risks are further heightened, particularly in the banking sector, through the increasing reliance on open account settlement by wire payment in place of traditional document-based trade finance instruments, which limits financial institutions’ visibility into the nature of the underlying trade activity and the identity of the transacting parties.

To assess this risk, the control assessment questions relevant to this risk theme were circulated to 15 LFIs, based on an inherent risk score calculated for this focused area, taking an equally weighted average of specific Key Data Elements (relevant to TBML). This was calculated based on the data provided in the AML/CFT Data Collection Survey.

The final assessment included only 13 LFIs due to discontinuation of related activities in the remaining 2 LFIs.



## THEMATIC REVIEW FINDINGS

This was a desktop review that focused on an assessment of the availability of controls and their design. Consequently, the findings in the report are drawn based on the assessment of responses to control assessment questions and supporting documents provided by each LFI.

The observations below indicate enhancements required in the overall AML/CFT Framework for some LFIs on specific financial crime risks associated with TFS and TBML. The examination outcomes suggest enhancements to TFS/TBML controls to better detect and prevent ML/TF activities, thereby safeguarding the integrity of the UAE's financial system.

LFIs across the sector should benefit from the outcome of the review. The important lessons learned should be shared across the sector to benchmark their own systems and controls and make any necessary enhancements.

It is also imperative to note that while LFIs with largest exposure to these risk themes were included in the review, the sample size was not sufficiently large enough to draw accurate conclusions as to the level of compliance across all LFIs operating in the mainland and the Commercial Free Zones ("CFZ"). Therefore, the results should be viewed as representative at thematic level only and not an actual representation of practices across all LFIs in the United Arab Emirates ("UAE").

Findings from the review are as follows:

### 1. GOVERNANCE

During the review it was observed that the majority of the LFIs that were in scope for this review have an understanding of AML/CFT Compliance Program. However, during the review we noticed gaps in terms of effective implementation on the same. This includes a range of measures aimed at the mitigation of TFS and TBML risks.

The responsibility of the senior management and BODs is documented within the relevant policies maintained by the LFIs. However, in some instances, the responses and the submitted documents by the LFI, did not clearly define the role of the senior management and BOD and therefore effectiveness around the implementation and delivery of the AML/CFT Compliance Program could not be determined.



It has been noted that the senior management and the BOD does not always maintain direct oversight on such risks.

#### **CBUAE EXPECTATION:**

Senior management and the BOD must take the ownership of the Compliance Program including exposure arising from TFS and TBML risks and mitigation measures. They must ensure effective delivery of the compliance program.

Senior management and the BOD must maintain closer oversight of the AML/CFT risks including TFS and TBML risks. This includes considerations such as appropriate and effective oversight of staff who engage in activities that may pose a greater AML/CFT risk; Reporting mechanism to inform the BOD (or a committee of the board) and senior management of compliance initiatives, compliance deficiencies, STRs filed and corrective actions taken; and Necessary structures in place wherein senior management and the BOD are accountable for clear ML/FT risk management and mitigation measures, as well as establish appropriate independent control functions.

## **2. ML/FT RISK ASSESSMENT**

The review reflected that the LFIs formally undertake the ML/TF Risk Assessment across all sectors but the design and operational implementation of this exercise requires room for improvement.

The review of the responses informed that the sector lacks thorough understanding of purpose of ML/TF and TFS Risk Assessment and the role such assessment can play in identification and mitigation of risks including risks related to TFS and TBML.

At large, the responses from the LFIs did not display effective use of these assessments for minimizing exposure to TFS and TBML risks. Issues such as -

It was noted that some LFIs used irrelevant data key risk indicators, incorporated inappropriate risk weighing of risk exposures, had limited coverage of risk types, focused on control design as opposed to control effectiveness, and subjectively evaluated controls.

#### **CBUAE EXPECTATION:**

Comprehensive ML/TF and TFS Risk Assessment methodologies must be adopted to adequately identify emerging risks including risks related to TFS and TBML. CBUAE expects all the LFIs to align itself with the relevant guidance issued by CBUAE on the



subject titled “CBUAE AML/CFT Guidelines for FIs”.

The LFIs must ensure that the adopted methodologies assess exposure to TFS and TBML risks adequately and appropriately.

The foundation of any risk assessment is the data used for the assessment, and hence the granularity of the data is important.

LFIs must start by defining appropriate key risk indicators that will assist in the identification of emerging risks including TFS and TBML risks. Once these indicators are defined, allocation of proper risk weights is instrumental in further strengthening the effectiveness of the assessment.

Similarly, while the assessment of controls from the design perspective is important, it is instrumental that LFIs also assess the control effectiveness implemented to reduce the exposure to TFS and TBML risks.

### 3. POLICY AND PROCEDURES

At large, the Policies and Procedure documents reviewed by CBUAE examiners outlined risks pertinent to TFS and TBML risks.

However, it was identified that the policies in some instances do not comprehensively cover the prevailing domestic regulatory obligations.

In the cases of UAE based operations of international banks, it has been observed that policies from the group or parent are being implemented without the required consideration to the domestic regulatory requirement and domestic business environment.

On Proliferation Financing (PF), majority of the LFIs included PF risks within the TFS Policy without maintaining a dedicated policy stance on the subject of PF. Limited coverage is provided on the topic of PF within the existing policy documents maintained by LFIs. For example, it was noted that very few LFIs had appropriate coverage on Dual-use goods (DUGs) and their monitoring. Majority of the LFIs that were part of the review did not outline obvious PF red flags, monitoring mechanisms and around DUGs, their monitoring and reporting obligations.

Similarly, procedure documents were generic and at times did not clearly outline PF roles and responsibilities across functions that are aimed to mitigate risks associated and faced by the LFI.

Typically, operational processes contained within Standard Operating Procedures



(SOPs) are expected to be more granular and provide clear step-by-step guides to risk mitigation. Failure to have detailed SOPs which are implementing tools of and overarching policy creates ambiguity and lack of clarity on suitable controls.

#### **CBUAE EXPECTATION:**

LFI must maintain clear and comprehensive policy documents in relation to TFS and TBML risks. The policy must remain aligned with the domestic regulatory obligations and expectations.

Where it is important for an LFI to align itself with the group or parent policy, LFIs must ensure that they do not diverge from the domestic obligations and requirements.

LFIs must also ensure that the topic of PF is adequately covered in the policy document including Red Flags pertinent to its operations and risk profile. This includes a clear policy stand on DUGs, monitoring mechanisms and reporting obligation.

LFIs must continuously enhance its procedures and must contain governing principles and standards that fit the nature, complexity and size of the LFI.. The procedure document must include procedures related to all processes in place for TFS and TBML including DUGs in line with the most recent AML/CFT Laws, Cabinet Decision and the CBUAE Guideline.

Wherever the size of the LFI allows, it must draw a separate policy and procedure document. If an LFI decides to draw one single document covering policy as well as the related procedures, clarity and distinctness must be ensured.

## **4. STRUCTURE**

Majority of the banking and finance sector LFIs distribute the responsibility of managing TFS risks between the first and the second line of defense. Business (First Line of defense) not only take the ownership of process but also the risk wherein the Compliance (Second Line of defense) assist business in designing the controls and reviewing the process. They also provide guidance and advice to business on High Risk cases/escalations.

However, it has been noted that within the second line of defense, not all LFIs that were part of the review have dedicated subject matter expertise in both TFS and TBML areas. We observed that in these LFIs, the resources manages both, AML and TFS risks, which impacts the overall quality of the guidance.



Similarly, on TBML risks, across the banking sector, the responsibility primarily lies with the first line of defense with limited contribution from the second line.

While reviewing the responses from the exchange house sector, CBUAE noted contrasting practice where management of TBML and TFS related risks are within the second line of defense. First line of defense takes minimal ownership of the risk pertinent to TFS and TBML.

#### **CBUAE EXPECTATION:**

LFI across all the sectors must move towards the three lines of defense model for managing risks including TFS and TBML risks.

First line of defense must take the ownership of the risks that emanate from their businesses. First line of defense must equally contribute for mitigation of TFS and TBML risks .

Second line of defense must support the first line of defense in the identification of risks and subsequent mitigation through their expertise on the subject matter. They must oversee all these risks to ensure that it is within the risk appetite of the LFI.

Unless the size and operations of the LFI does not allow, CBUAE expects LFIs to have dedicated expertise within the second line of defense to manage the exposure to TFS and TBML risks.

Third line of defense will provide independent assurance on the management of risks by the first and the second line of defense.

## **5. KYC CONTROLS**

The review of the responses received from the LFIs across all sectors and their policy documents informed that KYC controls are largely focused on customer identification and risk rating.

To mitigate risks associated with the high-risk customers, the review and approval of the Compliance Department prior to on-boarding is a common practice across all sectors. While this is a good practice, such an approach is only effective if quality information is captured and properly analyzed.

In some instances wherein trigger events, periodic reviews and comprehending the entire customer profile were not noted.

Particularly on risk rating process across the sectors, we noted that limited parameters



are being included to incorporate exposure to TFS and TBML risks.

While reviewing the responses on LFI's dealings with Shell Banks and Numbered Accounts, it has been understood that the sector not only clearly understands the prohibitions and risks related to dealing with Shell Banks and Numbered Account but has also maintains clear policy statements to govern their practices. However, majority of the LFIs did not demonstrate adequate understanding of risks pertaining to nested relationships, as majority of the responses did not adequately address the risks associated with this type of activity.

#### **CBUAE EXPECTATION:**

CBUAE expects LFIs to implement robust KYC controls including thorough analysis of the information that is being collected from the customer, including comprehending the risks associated with the customer and the exposure to the LFI, specifically in relation to high risk products and services such as Trade and TFS related transactions..

The LFI must include understanding of customer's business, line of activity, anticipated volumes, involvement of dual usage goods, customer's customers and country of operations etc. in its KYC processes.

## **6. MONITORING AND SURVEILLANCE**

The review focused on the practices across the sector to understand how LFIs monitor TBML threats.

The responses from the sector revealed that the monitoring of TBML related risks is largely a manual process where the first line of defense is responsible for review of trade documents, understand the customer profile and identify conventional red flags prevalent to TBML risks.

While reviewing the transaction monitoring mechanism across the sector, CBUAE identified that the automated systems across the sector could be further enhanced to detect TBML typologies, through the use of detection scenarios.

#### **CBUAE EXPECTATION:**

The LFIs must make efforts towards increasing the coverage and effectiveness of the automation of monitoring processes to aid in the identification of TBML risks.

CBUAE expects LFIs to utilize both automation tools and manual processes to identify and report of TBML risks.



CBUAE expects LFIs to incorporate specific TBML detection scenarios, to effectively monitor TBML typologies like over-invoicing, under-invoicing, multiple invoicing, over/under and ghost shipments.

To benefit the LFIs, below are some common TBML “Red Flag” Indicators, highlighted by FATF. CBUAE expect LFIs to ensure that they have built sufficient controls to mitigate the applicable risks:

- Significant discrepancies appear between the description of the commodity on the bill of lading document and the invoice;
- Significant discrepancies appear between the description of the goods on the bill of lading (or invoice) and the actual goods shipped;
- Significant discrepancies appear between the value of the commodity reported on the invoice and the commodity’s fair market value;
- The size of the shipment appears inconsistent with the scale of the exporter or importer’s regular business activities;
- The type of commodity being shipped is designated as “high risk” for money laundering activities;
- The type of commodity being shipped appears inconsistent with the exporter or importer’s regular business activities;
- The shipment does not make economic sense;
- The commodity is shipped to (or from) a jurisdiction designated as “high risk” for money laundering activities;
- The commodity is trans-shipped through one or more jurisdictions for no apparent economic reason;
- The method of payment appears inconsistent with the risk characteristics of the transaction;
- The transaction involves the receipt of cash (or other payments) from third party entities that have no apparent connection with the transaction;
- The transaction involves the use of repeatedly amended or frequently extended letters of credit; and
- The transaction involves the use of front (or shell) companies.

## 7. LIST MANAGEMENT

Majority of the re mainly dependent on third party vendors for procuring TFS related data. For certain LFIs, in addition to maintaining third party subscriptions, they also procure data directly from the source and upload onto their systems as a measure of precaution.

Noting that the sectors are mainly depending on third party vendors, majority of the



participants were not able to demonstrate how they ensure compliance with the provision of the related Cabinet Decision that requires listing decision to be implemented within 24 hours. Majority of the participants did not demonstrate any control or oversight on this obligation.

Similarly, majority of the LFIs do not conduct any completeness or adequacy check on the data that is procured from third parties for TFS related obligations, relying on the third party vendors to provide complete or adequate data.

On TBML, we noted that sector is not well educated about the role of Committee for Goods and Material Subjected to Import and Export Control in relation to DUGs. The sector to certain extent maintain list of DUGs, however it was not evident how this list is integrated into their due diligence processes.

It was also observed that in some instances, monitoring of DUGs is a manual process across the sector and that this list is not an automated screening process. Further, the dissemination of DUGs list as and when it is updated is not a formal process in some of the LFIs that were part of this review.

#### **CBUAE EXPECTATION:**

The LFIs must completely understand their regulatory obligations in the area of list management and take necessary measures to ensure compliance.

It can be beneficial for the LFIs to include in their SLAs with the third party vendors a condition that will ensure implementation of listing decision within 24 hours. In addition, the LFIs must introduce quality and completeness checks on the data that is procured from these third party vendors. These checks should be conducted at frequent intervals.

In relation to TBML risks, LFIs are expected to understand the role of Committee for Goods and Material Subjected to Import and Export Control and include in their due diligence processes the DUGs list maintained by the Committee for Goods and Material Subjected to Import and Export Control on their website. LFIs must have a formalized process for dissemination of this DUGs list across their organization as and when the Committee for Goods and Material Subjected to Import and Export Control updates it.

LFIs must also explore the opportunities to automate the screening of DUGs in order to be more efficient and effective.



## 8. INTERNAL AUDIT / EXTERNAL ASSESSMENT

It was evident from the responses that the Compliance Program across the sector is subjected to review by the third line of defense (internal audit).

However, despite CBUAE identifying areas of improvement based on this desk-based review, the LFIs responded that there are no outstanding findings by the internal audit in relation to TFS and TBML.

This could be due to the reason that internal audit department across the sector primarily derives its audit scope from the internal policies and procedure of the LFI and does not necessarily include regulatory requirements and obligations in its review.

With regard to external assessment, CBUAE noted that majority of the LFIs engage external experts to reinforce its over-sight on the compliance function and its efficiency. Exception was noted only in the finance sector where appointment of an external party to assess the effectiveness and efficiency of compliance function is not common.

### CBUAE EXPECTATION:

Third line of defense (internal audit) is a key pillar of any compliance program as recognized by all major standard setting agencies and bodies. The LFIs must understand the role of third line of defense and the value it adds to the overall success of the compliance program.

The scope of internal audit plans at an LFI must commensurate to its risk exposures to enable adaption of risk-based approach. If the exposure to TFS and/or TBML risks warrant, the LFIs must consider thematic audits of these areas of risks.

Equal importance must be given to the coverage of the internal audit wherein it must be ensured that the internal audit is also assessing the level of compliance with prevailing laws and regulations while reviewing the compliance program.

Development of skillsets that are required to identify emerging risks including TFS and TBML risks within the internal audit function must be treated as a priority by the LFIs.

If the size and the complexity of an institution allows, external experts must be engaged to assess the effectiveness of the compliance program across the three lines of defense. Scope of such engagements should primarily be the area of vulnerabilities within the compliance program.



## 9. TRAINING

While the CBUAE acknowledge that the topics of TFS and TBML are included in trainings across the sectors, CBUAE noted that there is room to improve the quality of content and coverage within these trainings.

The trainings do not include these topics from the policy; procedures and regulatory obligation's perspective rather focus on introducing basic concepts.

CBUAE also identified some LFIs who have utilized the application of role-based training concepts across the sector.

### **CBUAE EXPECTATION:**

LFIs must ensure that trainings are comprehensive and expose the audience to the advance learning as oppose to only building generic understanding around key risk areas.

Training around the areas of TFS and TBML must be seen as an opportunity to impart knowledge and understanding around not only the basic concepts but also the risk appetite, internal policies, procedures and regulatory obligations.

CBUAE also expects use of more real life scenarios including Red Flag, STR/SARs, fines etc. to be made part of the training programs to strengthen the understanding around these subjects.

The sectors must introduce and implement the concept of role-based trainings for the staff. Role based trainings are more efficient and effective as they center on the practical application of learned skill allowing more focus training for the targeted audience.



## CLOSING REMARKS

Central Bank of the UAE reminds FIs to remain abreast of all regulatory obligations under the UAE Federal Decree Law on AML/CFT and the Cabinet Decision no 74 on Implementation of UN Security Council Resolutions on the Suppression and Combating of Terrorism, Terrorist Financing, Countering the Proliferation of Weapons of Mass Destruction and other relevant regulations. We expect all LFIs to not only implement but also demonstrate that their AML/CFT & Sanction controls are robust and effective in preventing the financial system from being misused.

The mitigation of ML/FT crimes and ensuring effective Sanction Program remain a key priority for the UAE. It is also vital that Financial Institutions ensure that all staff maintain an awareness of ML/TF/Sanctions risks and how these are being mitigated and managed. Firms should study the recommendations of this publication and apply them accordingly.

If you have any queries regarding the contents of this report or any concerns arise or assistance is required, we request you to contact CBUAE AML/CFT Supervisory Team.