



# INVESTMENT BUSINESS **SECTOR REPORT**

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## **2020-2021**

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**Inspection Period: 2020-2021**

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## **Foreword**

The British Virgin Islands Financial Services Commission (“the Commission”) established the Onsite Compliance Inspection regime in 2002 for the specific purpose of conducting Inspections and reviews. The inspections and reviews are conducted with the aim of verifying the level of compliance as it relates to the AMLTF Code of Practice and other relevant legislation. This function is critical to ensuring that the British Virgin Islands continues to manage and mitigate risks appropriately and ultimately comply with international standards and maintain its standing as a leading international finance centre. Therefore, the Commission will continue ensure that onsite inspections are conducted at the level and frequency that allows it to meet its objectives and will proactively explore ways in which the process can be continuously improved.

The inspections conducted usually vary in scope based on the risks presented by a specific Licensee, a particular sector or the wider jurisdiction. . However, whether themed, or full scope, each inspection conducted allows the Commission to identify deficiencies as it relates to an entity’s Compliance, and further understand and mitigate risks presented.

Additionally, the findings garnered at the end of each review allow each Licensee to identify deficiencies and apply appropriate remedial action to strengthen its Compliance.

For the benefit of the wider sector, and industry at large, the findings for the latest round of reviews within the Securities and Investment Business sector have been collated, and are presented throughout this 2020/2021 sector report. In 2020, the Commission issued a report on cumulative findings for inspections, which covered inspections conducted in 2019. This report follows on from that and it is expected that reports covering compliance inspections undertaken will be published intermittently . Entities are encouraged to review the report, consider the key findings, and whether the recommendations outlined are applicable and require integration into their operations.

We are committed to ensuring that our Licensees comply with legislation, prudential standards and other best practice and that VI maintains its standing and reputation by complying with international standards. Further where licensees are found wanting we are committed to taking proportionate and dissuasive sanctions.

## **Objective of Report**

The objective of this report is to arrive at cumulative findings that allow the Commission to identify areas that present the highest level of risks. The identification of such areas would allow the Commission to assess the probability and potential impact of risks identified, and apply appropriate and proportionate risk treatments.

An assessment of the performance of Licensees within various sectors serve as a tool for identifying areas which would require heightened supervision techniques and monitoring. In addition, this assessment will establish a foundation through which future sector findings can be compared and contrasted. This would be done with a view to determining whether the sector is improving, worsening or remaining stagnant as it relates to AML compliance.

Furthermore, where there appear to be inherent gaps, it may point to the need for legislative changes, or issuance of appropriate guidance to the sector. The assessment would also serve to improve the

Commission's general communication (FAQs, circulars, newsletters etc.) by focusing on the most pressing and complex issues.

### **Limitation of Work**

The purpose of this report is to review and compile the findings of the 2020 and 2021 inspections conducted for Licensees licenced under the Securities Investment Business Act (SIBA). Consequently, the Commission can draw conclusions on the level of compliance of these Licensees, and implications for the sector.

### **Scope and Methodology**

The Compliance Inspection Unit, in accordance with its risk based approach, selected eleven (11) entities licensed under SIBA for the purposes of conducting a thematic review.

SIBA allows for a license to be obtained under various categories as follows<sup>1</sup>:

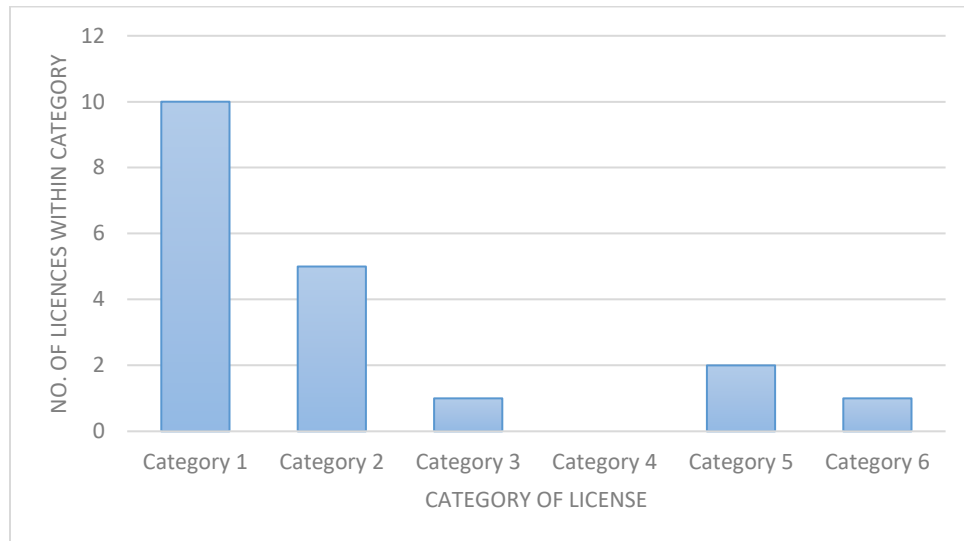
- Category 1 – Dealing in Investments
  - *(buying, selling, subscribing for or underwriting investments as an agent or principal)*
- Category 2 – Arranging Deals in Investments
  - *(making arrangements with a view to another person buying, selling, subscribing for or underwriting investments).*
- Category 3 – Investment Management (
  - *managing investments belonging to another person, or managing a mutual fund)*
- Category 4 - Investment Advice
  - *(advising a person on investments)*
- Category 5 – Custody of Investments
  - *(acting as custodian or depositary of assets belonging to another person, or acting as custodian of a mutual fund or trustee of a unit trust)*
- Category 6 – Administration of Investments.
  - *(Administering or arranging for the administration of assets belonging to another person, or as an administrator of mutual fund)*

Table A below illustrates the categories of licences under SIBA, which were held by the eleven Licensees that comprised the thematic review.

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<sup>1</sup> The list of categories below do not include various sub-categories.

**Table A**



Six (6) Licensees included within the scope of the thematic review, held a SIBA licence across multiple categories. Furthermore, ten of the Licensees within the scope of the assessment held a Category 1 Licensee, providing for Dealing in Investments.

To conduct the assessment, a pre-inspection questionnaire was disseminated to each Licensee requesting specific information and the provision of relevant policies and procedures. Subsequently, client files were requested and reviewed to determine the level of implementation and effectiveness of the Licensee's policies and procedures as it relates to the requirements of the AMLTF Code of Practice.

The Inspections conducted were specifically geared to assess each Licensee's level of compliance with the following sections of the AMLTF Code of Practice:

- Section 12 of the AMLTF Code of Practice: [*Duty to Carry out Risk Assessment*]
- Sections 20 & 22 of the AMLTF Code of Practice: [*Requirements of Enhanced Customer Due Diligence & Politically Exposed Persons*]
- Section 21 of the AMLTF Code of Practice: [*Requirement to Update Customer Due Diligence*]

However, it should be noted that two of the eleven Licensees included in the scope of the assessment were only assessed for their level of technical compliance as each Licensee did not have an active client base to allow for the implementation of its procedures.<sup>2</sup>

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<sup>2</sup> This information is at the time of the inspection conducted.

## Findings

As a result of the thematic inspections conducted, a rating was applied to each of the three sections reviewed. The ratings were applied as follows:

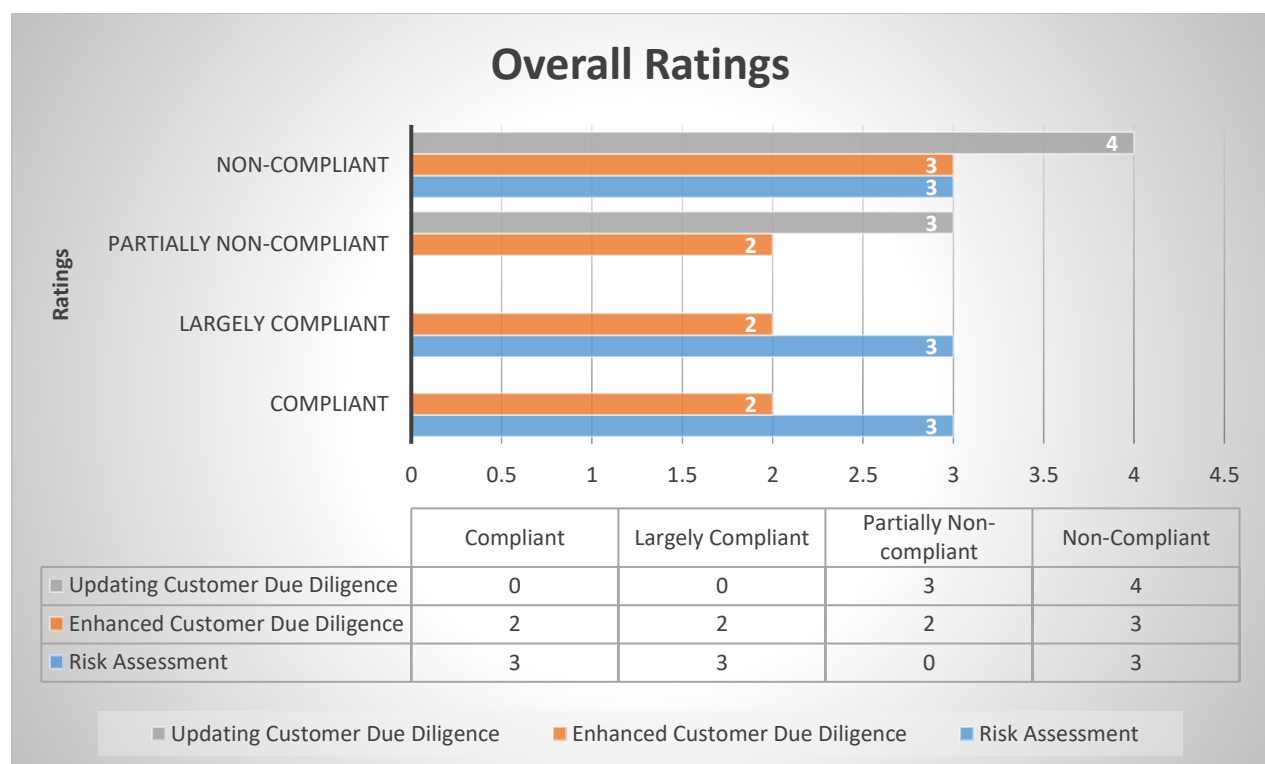
- Compliant – reflecting compliance with all legislative requirements without any significant deficiencies.
- Largely Compliant – reflecting minor shortcomings with a majority of legislative requirements.
- Partially Compliant - reflecting shortcomings with a majority of the legislation.
- Non-compliant.- reflecting severe shortcomings with a significant majority of the legislation.

The Commission as a matter of policy, views ratings of Largely Compliant and above as within its risk appetite whilst ratings of Partially Compliant and Non-Compliant are viewed as outside of its risk appetite. Therefore, areas which fall outside of the Commission’s risk appetite would be subject to more stringent and intrusive actions inclusive of potential enforcement action.

Of the Licensees reviewed, only three Licensees were generally within the Commission’s risk appetite as they were able to attain a rating of Largely Compliant in two or more sections assessed. The remaining Licensees exhibited significant deficiencies in complying with a majority of the areas assessed as part of the thematic review.

Specifically, [Table B](#) illustrates the overall ratings achieved by the Licensees for the areas assessed.

**Table B**



In totality, nine Licensees were generally assessed for level of compliance of their controls and policies with legislation as well as extent of implementation of those policies and controls. . However, various

Licensees did not meet certain criteria to allow for the assessment of the implementation of its policies and procedures.

Specifically, as it relates to updating of customer due diligence, seven of the nine Licensees (representing 78%) were assessed and received a rating, as the other two Licensees had no clients eligible for review.

Furthermore, as it relates to ECDD, five of the nine Licensees (representing 56%) were assessed for the level of implementation of ECDD controls, as those were the only Licensees whose sample contained high risk clients requiring the conduct of ECDD.

However, all nine Licensees were rated as it relates to its mechanisms in place to identify a Politically Exposed Person.

#### Aggregate Findings

- There were **significant deficiencies in complying with Section 21 of the AMLTF Code of Practice** – 57% of the Licensee's Licensees tested demonstrated significant shortcomings in complying with legislation, and received a rating of non-compliance. No Licensee attained a rating of Largely Compliant or Compliant.
- There was a **high level of compliance as it relates to section 12 of the AMLTF Code of practice as it relates to the conduct of Risk Assessment**. In this regard, 67% of Licensees achieved a rating of either Largely Compliant or Compliant, reflecting minor shortcomings with compliance to the AMLTF Code of Practice.

## Key Findings

### Risk Assessment

#### Risk Assessment Framework

Deficiencies were identified in the Risk Assessment Framework and matrices established by various Licensees within the sample. Such deficiencies were as follows:

- Establishment of a risk framework and risk matrix, which did not take into consideration all risk factors (geographical, customer, product) presented by each client as required by the AMLTF Code of Practice.
- Use of a risk matrix to risk assess clients that is not in accordance with the established risk assessment framework.
- Production of a risk rating of a client that does not equate to the actual risks presented by the client.

#### Conduct of Risk Assessment

The Thematic reviews also assessed the implementation and effectiveness of the risk assessment framework. Firstly, the thematic review assessed the rate of conduct of risk assessments on clients by each Licensee.

Table C illustrates the percentage of clients within each Licensee's sample that were risk assessed by the Licensee.

**Table C**

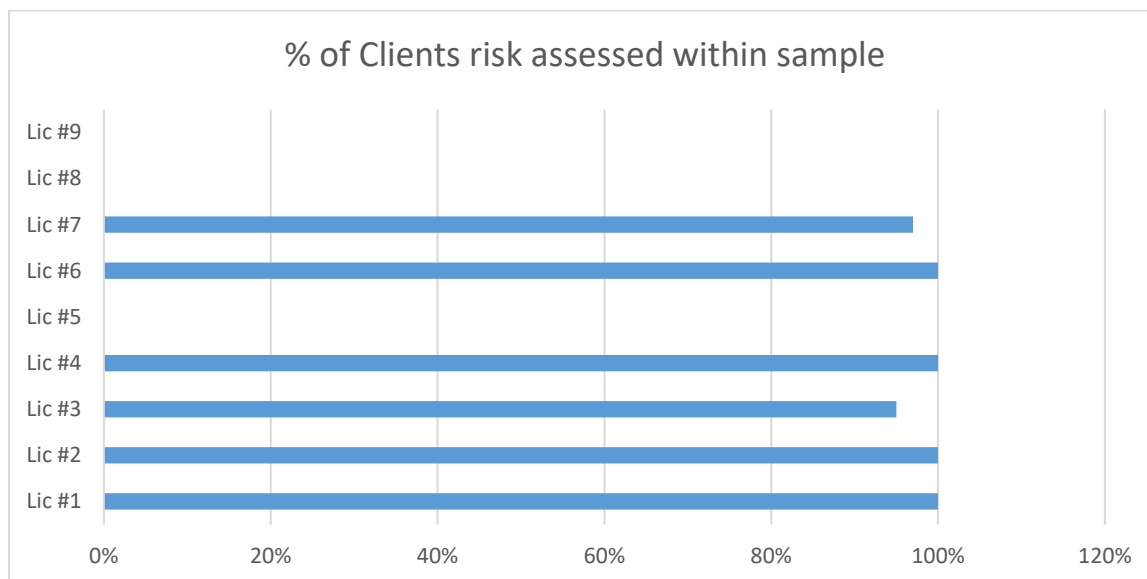


Table C illustrates the following findings:

- six (6) of the nine (9) Licensees (*representing 66%*) were able to risk assess 90% or more of clients that were sampled.
- three (3) of the nine (9) (*representing 33%*) Licensees did not conduct any risk assessments on clients sampled.



- As it relates to conformity of section 12, there was either a rate of high compliance or non-compliance by Licensees.

However, in various instances where risk assessments were conducted, there were flaws in the ratings produced. Specifically, 8% of the risk assessments conducted had an inaccurate rating. The errors in the risk ratings assigned can be attributed to deficiencies in the Licensees' risk assessment process which did not entirely consider necessary customer circumstances or failure to adhere to the established risk assessment frameworks. As such, where section 20(4) required, a rating of High risk – the files were inaccurately risk assessed as Low.

Consequently, the ratings assigned overall was as follows:

	<b>Compliant</b>	<b>Largely Compliant</b>	<b>Partially Compliant</b>	<b>Non-Compliant</b>
<b>Risk Assessment</b>	3	3	0	3

## Requirements of Enhanced Customer Due Diligence (ECDD)

### Enhanced Customer Due Diligence Framework

To determine the level of compliance as it relates to section 20 and 22 of the AMLTF Code of Practice, the thematic review firstly reviewed and assessed the Licensee's written controls for ECDD. Weaknesses identified in the procedures, would further link to weakness in the implementation and effectiveness of the ECDD measures.

In this regard, deficiencies were found with respect to the written controls of nine of the eleven (11) Licensees assessed. Specifically:

- Five (5) of the Licensees' ECDD controls did not detail the additional measures to be taken where ECDD would be required.
- Three (3) Licensees did not include the requirement for senior approval of high-risk clients as part of their written controls.
- Controls for an additional Licensee included measures for dealing with PEPs but was silent on controls for other categories of high risk clients.

### ECDD Implementation

Of the eleven Licensees, five Licensees had high risk customers which would have required the implementation of the ECDD controls.

Such controls in accordance with section 20(3) would require the collection of additional documentation for high risk customers to allow the Licensee to a) obtain further knowledge and (b) additional awareness on each client.<sup>3</sup> Additionally, senior management approval would also be required.

Table D illustrates the rate of implementation of ECDD controls.

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<sup>3</sup>For the Licensees reviewed, such controls required the collection of References, Bank Statements or other additional documentation commensurate with the risks identified by the client.

**Table D**

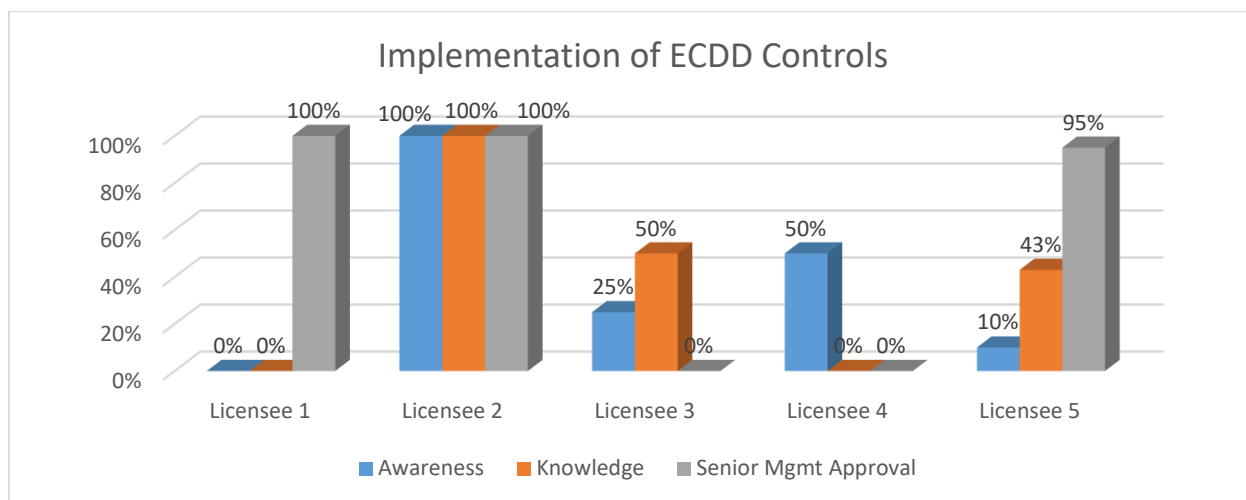


Table D illustrates the following findings:

- Only one of the five Licensees fully implemented its ECDD measures.
- On average, there was a compliance rate of 60% as it relates to seeking senior management approval
- On average, there was a compliance rate of 37% and 39% as it relates to the compliance level for obtaining additional knowledge and awareness respectively.

### **Politically Exposed Persons**

As regards procedures for identification of PEPs, it was found that two (2) of the Licensees relied on clients to complete a declaration to confirm their PEP status. In one case this was done for all clients and in the other instance, it was allowed for clients coming from low -risk jurisdictions. In any event, these unverified declarations could result in a PEP failing to make the appropriate disclosure and hence not being subject to the appropriate level of controls.

Also, one (1) Licensee indicated that it conducted worldcheck and internet searches as a means of identifying PEPs. This was evidenced through completing a section of its checklist. However, this control does not result in physical evidence being produced that the search was actually carried out.

However, there were no PEPs within the sample, and as such the implementation of the controls relating to section 22 of the AML Code of Practice was not assessed. Consequently, the overall ratings assigned took into consideration the controls utilised to identify PEPs, as well as the level of compliance with implementing ECDD controls. Ratings assigned are as follows:

	Compliant	Largely Compliant	Partially Compliant	Non-Compliant
Enhanced Customer Due Diligence	2	2	2	3



## Update of Customer Due Diligence

### Written Controls

Four (4) of the eleven (11) Licensees did not establish controls to ensure that reviews and updates were carried out in accordance with the timeframes detailed in section 21 of the AMLTF Code of Practice.

Additionally, there were various deficiencies identified with the controls of the remaining Licensees as follows:

- Controls required reviews be conducted at specific instances (i.e. a transaction exceeding a certain value) as opposed to specific time intervals. This presented a deficiency due to the fact that if the trigger event never occurred, a review would not be undertaken.
- Controls did not explicitly detail the review procedure that would be undertaken by the Licensee. Such procedure should be detailed to ensure that employees are aware and understand the review process and ensure that the review is conducted in a consistent manner.
- Controls required the conduct of worldcompliance/worldcheck searches at continuous intervals as part of its requirement to review and update CDD. However, such control has inherent weaknesses- as it does not allow for the update or consideration of other elements of CDD such as the validity of passport, and whether the circumstances relating to the client remain the same.

Furthermore, five (5) Licensees utilised various automated transaction monitoring systems as part of its monitoring. These systems for the most part focused on identifying activities that deviated from those disclosed at the onset of the relationship. However, for such systems to work effectively – sufficient information should be collected at the onset of the relationship to form a base point. However, this was not evidenced with two of the five Licensees within the sample.

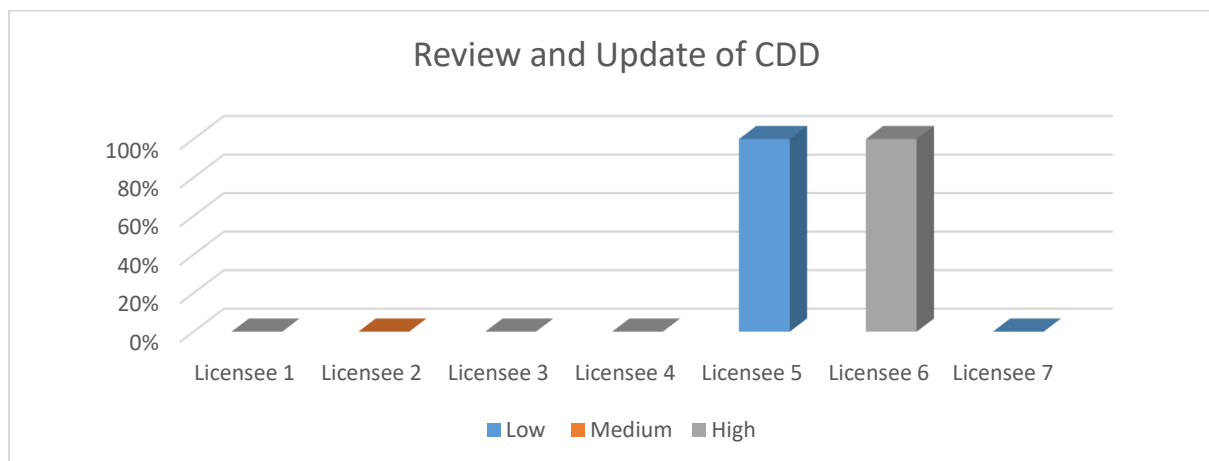
### Implementation

The thematic review also assessed the level of compliance as it relates to carrying out the reviews on applicable clients. At the time of the thematic reviews, 6 (six) Licensees had client relationships eligible for review.<sup>4</sup> Table E demonstrates each Licensee's level of compliance as it relates to conducting reviews on eligible client relationships. It should be note that there was a total of 72 client relationships eligible for review.

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<sup>4</sup> The remaining Licensee's did not have any clients eligible for review, due to maintaining a relatively new client base as well as absence of high risk customers, which would eliminate the need for annual review.

**Table E**



There were significant deficiencies identified in the Licensees' ability to comply with section 21 of the AMLTF Code of Practice. Table E illustrates that there was either a level of moderate compliance or no compliance. Furthermore, the highest level of compliance was demonstrated in the review of low risk clients (on a four year basis).

It was apparent that the Licensees failed to utilise their mechanisms in place to review and update customer due diligence and this was further evidenced in the fact that 21 of 72 (representing 29%) of client relationships contained an expired identification document.

Though only two Licensees made strides in reviewing and updating CDD, two other Licensees utilised automated transaction monitoring processes to provide ongoing monitoring of client transactions. Such mechanism was taken into account in deducing the overall ratings as follows:

	Compliant	Largely Compliant	Partially Compliant	Non-Compliant
Review of CDD	0	0	4	3

### **Remedial Action**

Based on the findings, relevant Licensees were issued corrective actions requiring the amendment of policies and/or procedures to remedy the deficiencies identified. To ensure that the amendment achieved the outcome of compliance, the corrective action further required the implementation of the amended policy and procedure on the client base. Subsequently, periodic reports were submitted on the level of implementation of amended policy/procedure and overall compliance.

### **Enforcement Action**

In addition to the correction actions issued, five Licensees were subject to enforcement action under section 37(2)(eb) of the Financial Services Commission Act, 2001.

## Recommendations

Based on the findings presented from the thematic reviews, it was noted that there were common deficiencies and trends amongst the Licensee's within the sample. To ensure that the appropriate controls and mechanisms are utilised by Investment Business Licensees, and other applicable sectors, the following general recommendations have been made<sup>5</sup>:

### Risk Assessment

- **Recommendation 1** – Establish a risk assessment framework that considers all applicable risk factors as outlined in the AMLTF Code of Practice.
- **Recommendation 2** – Adopt and apply such risk assessment framework appropriately. Licensees should ensure that the risk matrix utilised is consistent with the framework, and considers and applies a rating for key risk factors.
- **Recommendation 3** – Conduct an appropriate risk assessment, on each client or applicant for business.

### Enhanced Customer Due Diligence (ECDD)

- **Recommendation 4** – Establish written ECDD controls that achieve the requirements of section 20(4) of the AMLTF Code of Practice. It should be noted that section 20(4)(a) does not prescribe the specific documentation that should be collected as part of ECDD. However, it requires that the controls allow for additional awareness and knowledge to be garnered on high risk clients. Such controls should be commensurate with the Licensee's established risk management framework.
- **Recommendation 5** – Ensure that established ECDD controls are applied on all high risk clients.
- **Recommendation 6** – Ensure that senior management approval is sought for all high risk clients.

### Politically Exposed Persons (PEPS)

- **Recommendation 7** – Ensure that there is an appropriate mechanism that allows for the identification of PEPs. Such mechanism should be appropriate and commensurate with the nature, jurisdiction and size of the Licensee's clientele.
- **Recommendation 8** – Ensure that ECDD controls are also applied to PEPs. Such controls should also require the Licensee to verify the source of funds/wealth of the PEPs.

### Requirement to Update Customer Due Diligence

- **Recommendation 9** – Establish a review procedure that sets out the time frames for review, along with the procedure in place to review each client.
- **Recommendation 10** – Ensure that the review procedure also allows for the review of pertinent CDD information relating to the client (ID, address, Source of Funds)
- **Recommendation 11** – Establish a mechanism to trigger the review of clients at the specified or required interval.

The areas covered in this report will continue to remain topics of focus and will be covered in future inspections. Additionally, the areas will be highlighted as part of the Commission's desk based

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<sup>5</sup> These are general recommendations and should be taken into consideration with the AMLTF Code of Practice and other relevant financial services legislation

supervisory mechanisms. Recommendations will also be taken into consideration as it relates to any guidance or training (via master classes) conducted by the Commission.