

**To** : **Regulated Entities:**

- i. Cyprus Investment Firms ('CIFs')**
- ii. Administrative Service Providers ('ASPs')**
- iii. UCITS Management Companies ('UCITS MC')**
- iv. Self-Managed UCITS ('SM UCITS')**
- v. Alternative Investment Fund Managers ('AIFMs')**
- vi. Self-Managed Alternative Investment Funds ('SM AIFs')**
- vii. Self-Managed Alternative Investment Funds with Limited Number of Persons ('SM AIFLNP')**
- viii. Companies with sole purpose the management of AIFLNPs**
- ix. Small Alternative Investment Fund Managers ('Small AIFMs')**
- x. Crypto Asset Service Providers**

**From** : **Cyprus Securities and Exchange Commission**

**Date** : **2 May 2023**

**Circular No** : **C550**

**Subject** : **Common weaknesses/deficiencies and good practices identified during the onsite inspections performed in relation to the prevention of money laundering and terrorist financing**

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The Cyprus Securities and Exchange Commission ('CySEC') wishes, with this circular, to inform the Regulated Entities of the following:

During 2021 and 2022, CySEC performed onsite inspections to its Regulated Entities to assess their compliance with the Prevention and Suppression of Money Laundering and Terrorist Financing Law of 2007, as amended ('the AML/CFT Law') and CySEC's Directive for the Prevention and Suppression of Money Laundering and Terrorist Financing ('the Directive').

Findings from these inspections evidenced some examples of good practices, although CySEC also observed some common weaknesses/deficiencies across the Regulated Entities. In addition to the measures already outlined by CySEC to facilitate Regulated Entities' full compliance with their AML/CFT requirements, CySEC provides recommendations for the Regulated Entities to implement.

## **A. Consolidating good practices identified**

CySEC identified the following good practices when carrying out its onsite inspections:

- **AML/CFT Internal Control Measures:** Keeping AML/CFT policies and procedures up to date to ensure compliance with evolving legal and regulatory obligations.
- **Record keeping:** Records of customer identification and transactions data and information are retrieved quickly and without delay.
- **Governance:** Approval of AML/CFT policies, procedures and controls by senior management with appropriate competence and accountability. In addition, senior management taking leadership on AML/CFT and sanctions issues, for example through everyday decision-making and staff communications.
- **Automated IT tools for AML/CFT purposes:** Implementation of automated systems for client due diligence (CDD), risk assessments, monitoring of transactions/accounts to spot suspicious activity and automated screening systems for obtaining and assessing information about their customers or beneficial owners' backgrounds.
- **High-risk customers:** Using, where available, local knowledge and open source internet checks to supplement commercially available databases when researching potential high-risk customers including PEPs.

## **B. Common weaknesses/deficiencies identified**

CySEC identified the following common weaknesses/deficiencies when carrying out its onsite inspections:

### **i. Customer Due Diligence (CDD) Measures**

- On a number of occasions, the Regulated Entities failed to construct and/or update a complete and proper customer economic profile either due to failing to collect information of the size and source of income, expected turnover, source of funds and size of wealth, or due to failing to collect evidence to verify and document the above information. In particular, in some instances, the Regulated Entities collected documentation for verification of the customer's source of funds and source of wealth, without verifying the reliability of the said documentation or obtaining supplementary information from other reliable independent sources.
- In some instances, CySEC found weaknesses in the risk-based approach processes to verifying the collected customer's data and information, thus contributing to poor customer economic profile-building. This included insufficient measures taken to verify the size of income and the source of customer funds and wealth.
- In relation to the nature of business, while a general statement as to the nature of business was provided, in a number of cases, Regulated Entities were found not to collect evidence to verify the customers' main business activities and operations. A broad and generalised description and documentation of customers' activities and operations, or

lack of (accurate) information, may lead the Regulated Entity to not fully understand the risks associated with the customers' business activities. This entails a risk that the Regulated Entity will not be able to conduct accurate follow-up of the business relationships, thereby reducing its ability to monitor the customers' transactions in a satisfactory manner – ultimately increasing the overall ML/TF risk.

- In some instances, the Regulated Entities relied upon the CDD information collected at the beginning of the business relationship, for constructing the customer's economic profile, and failed to perform ongoing updating of the economic profile as the business relationship evolves or following a triggering event e.g. adverse media, material change in the status of the customer.

## **ii. Enhanced Due Diligence (EDD) Measures**

- On a number of occasions, although the Regulated Entities had classified customers as high risk, there was lack of evidence to verify that the Regulated Entities obtained additional information in order to apply enhanced customer due diligence measures, in addition to the measures referred to in sections 60, 61 and 62 of the AML/CFT Law, thus mitigating the associated ML/TF risk.

## **iii. AML/CFT Risk Assessments**

- In a number of cases, the Regulated Entities, when conducting the customer's AML/CFT risk assessment, failed to take into consideration the Risk Factors Guidelines, as per paragraph 12(4) of the Directive (CySEC Circular C276) and in the case of the ASPs sector, the Risk-based Approach (RBA) Guidance for Trust and Company Service Providers (TCSPs) adopted by the Financial Action Task Force (FATF) (CySEC Circular C331).
- For business relationships with customers and/or customers' beneficial owners who have acquired, either themselves or their spouses and/or their children, Cypriot citizenship under the Cyprus Investment Program (CIP), in some cases, the Regulated Entities have not always accounted for the risks posed by these customers in their AML/CFT risk assessments. As a result, the Regulated Entities did not demonstrate an effective and thorough assessment of the ML/TF risks posed by the said customers, and thus not implementing appropriate CDD measures.
- In some cases, the Regulated Entities failed to flag and properly assess published adverse information, relating to the reputation of their customers and/or beneficial owners.

## **iv. Customers' Screening and Transactions Monitoring**

- In some instances, although the Regulated Entities performed customer's background checks through screening databases, those checks were not always recorded and documented. Those screening records should be maintained in the customer's file, especially when the checks resulted in 'false-positive' matches, in order to have an audit trail that the matches were investigated and resolved as 'false-positives'.

- On a number of occasions, the Regulated Entities failed to collect supporting documentation of the customer's transactions conducted, in order to ensure that a satisfactory audit trail is maintained.
- In particular, with respect to the ASPs sector, it has been identified that in some cases, loan agreements were obtained as supporting documentation of transactions, without an apparent economic or financial purpose.
- In addition, it was observed that a number of ASPs and Fund Managers, rely on credit institutions for conducting their customer's transactions monitoring without applying appropriate internal transactions monitoring mechanisms.

With the publication of the above common weaknesses and deficiencies identified during the onsite inspections, CySEC takes this opportunity to present to the Regulated Entities the areas in which they should pay close attention to and to assist in formulating an environment of compliance with their AML/CFT obligations. Among other, CySEC warns Regulated Entities of their obligation to verify the identity and economic profile of their customers by requesting the appropriate documents and other information, as well as to monitor their transactions on a continuous basis. Through this process, risks related to money laundering, identity theft, financial fraud, and terrorist financing are reduced. In addition, CySEC wishes to remind Regulated Entities, that in the event of non-compliance, they will be subject to the administrative sanctions available to and enforced by CySEC under the AML/CFT Law.

Sincerely,

Dr George Theocharides  
Chairman  
Cyprus Securities and Exchange Commission