



U.S. Commodity Futures Trading Commission

Technical Assistance Program

AML, KYC , and Crypto Currencies

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Disclaimer

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The Introduction of Crypto Currency

- ▶ No firms are accepting crypto currencies as of yet
 - Will possibly do so in the near future
- ▶ The currency does not change requirements
 - KYC
 - Source of funds
 - Ultimate beneficiary
 - Heightened sensitivity
- ▶ Crypto enforcement activity now focused on un-registered firms/activity, Ponzi schemes

KYC and Crypto Currency

When Customers want to purchase crypto futures:

- ▶ Enhanced customer due diligence
- ▶ Ensure customer is qualified
- ▶ Ensure customer is suitable for the risk
- ▶ May want to require higher initial and variation margin
- ▶ Monitor trading activity closely
 - Understand the trading strategy of the customer
- ▶ Be prepared to liquidate trades
- ▶ Enhanced training for staff

KYC and Crypto Currency

Customers who want to purchase crypto futures:

- ▶ Proper risk disclosures for futures trading
 - Liquidity
 - Volatility
 - Custody (if physically settled)
 - Pricing
 - Risk of loss
 - Cash market is unregulated
 - Risk of fraud in cash market is high

KYC and Crypto Currency

Customers who want to trade Crypto Funds

- ▶ High risk so therefore enhanced customer due diligence
- ▶ Disclosures are the same as with futures contracts but additional risk disclosures with crypto funds
 - Redemptions could be stayed
 - Pricing of fund assets
 - Hedging strategy
 - Illiquid trading volumes
 - ETFs are not always the answer, could be deceiving!

AML and Crypto Currency

AML Concerns with Crypto Currency:

- ▶ Distributed Ledger Technology makes it very difficult to know the true source of the funds
- ▶ Need to identify beneficial owners, true identity of account owner
- ▶ Transaction monitoring is important
- ▶ Unusual patterns or activity
- ▶ Suspicious Activity Reports must be filed
- ▶ Crypto currencies are the currency of choice for bad guys

AML and Crypto Currency

- ▶ Heightened staff sensitivity to the potential for money laundering
- ▶ Enhanced training of staff
- ▶ Enhanced governance
 - Board level
 - Managers and supervisors
 - Exception reporting needs to be modified for cryptos
 - Reports to management
- ▶ Enforcement will be tough!

AML and Crypto Currency

- ▶ If a firm accepts crypto as payment
 - Know the true source of the funds
 - Follow the chain as far back as possible
 - Know your customer and beneficial owner
 - Understand why they are using crypto assets
 - Is it consistent with the account trading and structure?
- ▶ How will the firm dispose of the crypto asset?
 - Hedge or hold (speculate)
 - Charge to capital

AML and Crypto Currency

- ▶ What about the crypto spot market?
 - Mainly unregulated
 - High risk of fraud
 - Some regulated exchanges in the US
 - LedgerX
 - More to come – Facebook?
 - Must register with the CFTC as a Designated Contract Market (DCM)
 - Comply with all CFTC regs

Regulatory Notices

- ▶ FINRA AML Reg Notice 19-18, May 6, 2019
 - Reinforces the need for an effective AML program
 - “Establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under [the BSA]”
 - Filing of SARs
 - Identifies a number of red-flags

Regulatory Notices

FATF Guidance July 2019

- Updates previous guidance
 - June 2014 – heightened risks with crypto's
 - Limited identification and verification available
 - Lack of clarity on responsibility for AML compliance
 - Lack of central oversight body
 - Convertible crypto's present greater risk than non-convertible
 - June 2015 –
 - Outlined risk based standards
 - Focus on “convertible virtual currency exchangers”
 - October 2018 –
 - Added Virtual Asset Service Providers definition
 - Exchange between fiat and VA
 - Exchange between one or more Vas
 - Transfer of VAs
 - Safekeeping /admin of VAs
 - Provision of financial services for issuance of VA

Regulatory Notices

FATF Guidance July 2019

- States Virtual Asset Service Providers have same full set of obligations as other financial institutions
 - Require VASPs to identify, assess and address AML
 - Require VASPs to take preventative measures such as customer due diligence, record keeping and suspicious reporting
 - Cooperate with authorities from other countries
 - Train staff to understand VASPs
 - Higher risk associated with VAs
 - Understand the centralized and decentralized models
 - Understand risks of anonymity-enhanced crypto's
 - “Travel rule” for money transfer applies to VASPs
 - Originators name,
 - Account number (wallet),
 - Physical address, national ID
 - Beneficiary’s name
 - Beneficiary’s account/wallet
 - Secure info “immediately and securely”

Regulatory Notices

UK FCA paper on money laundering risks June 2019

- Nice Annex on AML typologies
- Findings
 - More awareness of AML for money laundering and not just market abuse
 - Need to submit SARs for money laundering, not just market abuse
 - Accountability for AML with front office, not just compliance and back office
 - Enhanced training, not just basic AML module
 - Cannot rely on others in the transaction chain
 - Know customer's intended trading strategies and business model

RegTech Innovations

FINRA RegTech Innovations Sept. 2018

- Biometrics to identify and track customer activity
- DLT for KYC databases
- Combine data received from customers to external sources – more holistic view of customer
- Central utility for KYC

Appendix AML/KYC Framework

AML Regulations

- ▶ Normal, high level AML regulations at CFTC
- ▶ NFA has more focused rules
- ▶ An AML program is a set of procedures designed to guard against someone using the firm to facilitate money laundering or terrorist financing. The minimum requirements of a program are:
 - Internal policies, procedures and controls reasonably designed to achieve compliance with the Bank Secrecy Act and implementing regulations;
 - Appointment of a designated compliance officer to oversee the program's day-to-day operations;
 - An ongoing training program;
 - An annual independent audit; and,
 - Appropriate risk-based procedures for conducting customer due diligence including, but not limited to:
 - understanding the nature and the purpose of developing a customer risk profile; and
 - conducting ongoing monitoring to detect and report suspicious transactions and on a risk basis to maintain and update customer information including identifying and verifying beneficial owners.

Program Standards

Key Elements

- ▶ Clear Policy and Procedures
 - All employees have a responsibility
 - Consequences of not following P&P
 - Form “reasonable belief” know true identity & recognize suspicious activity
 - Required to report to supervisor
 - Audit trail for law enforcement follow up
 - NFA has a web-based AML procedures system
- ▶ Customer Identification Program (CIP)
- ▶ Comparison with government lists
- ▶ Foreign Private Banking and Correspondent Account due diligence
- ▶ Independent annual audit

Program Standards, cont.

- ▶ FCM vs. Introducing Broker
 - FCM may rely on another financial institution if:
 - Reliance is reasonable
 - Other firm is subject to AML requirements and oversight
 - Written contract requiring firm to certify annually it has an AML program and will perform requirements
- ▶ Clearing FCM vs. Executing FCM
 - Clearing FCM has the relationship and must perform AML oversight
- ▶ May outsource AML compliance, but...

Oversight

▶ Baseline

- 70% of all US futures trading is undertaken by institutions
- Most OTC Foreign Exchange trading is retail
 - Increase in on-line FX solicitation and trading
- Most FCMs are also subject to banking regulatory oversight
- Bad guys need to invest and risk manage their investments in FX and futures markets...

Oversight

- ▶ Firm Annual Self-Examination Questionnaire
- ▶ Compliance Officer/AML-KYC Officer
- ▶ Internal Audit
- ▶ NFA/CFTC
 - Part of standard examination program
 - Covered at least once every three years
 - Risked based exams
 - On-line new customer activity
- ▶ Whistleblower program

Oversight

- ▶ Key controls and governance
 - Clear guidance from senior management – compliance vs. increased revenue
 - AML Oversight Committee at larger institutions
 - Board of Director reporting
 - Account opening process
 - Do not do business with list
 - OFAC and other government list scans
 - PIPs
 - Shell companies

Oversight

- ▶ Key controls and governance
 - Account monitoring
 - Transaction monitoring
 - Transfers between accounts
 - Use of data mining
 - Smurfing transactions
 - Unusual patterns or activity
 - Wire activity

Monitoring Tools

▶ KYC databases

- Artificial Intelligence systems
 - “making a good faith effort” can engage in “trial and error experiments with technology”
- Agencies may provide “feedback,” pilot programs not subject to supervisory criticism even if unsuccessful
- Distributed Ledger Technology on horizon

Monitoring Tools

- ▶ Customer activity monitoring
 - Develop a standard pattern for deposits, withdrawal
 - Trade data mining
 - Products, size, type
 - Level of activity
 - Consistent with KYC profile
- ▶ Use of all available government lists
 - Consider all countries not just home country
- ▶ Monitor employee activity? 1MDB

Expectations of FCMs

- ▶ Senior management support
- ▶ Firm culture
 - Sales vs. compliance
 - Budget vs. effectiveness
- ▶ Staff training
 - Automated vs. classroom
- ▶ Effective internal controls
 - New customer pre-approval
 - Customer due diligence
 - Activity monitoring

Expectations of FCMs

- ▶ Exception Reporting
 - Adequacy of reports
 - Trends
 - Escalation
 - SAR filing
- ▶ Reports to senior management
 - How does senior management respond?
- ▶ Reports to Board of Directors
- ▶ CCO Annual Compliance Report

Enforcement Actions

- ▶ Banking regulators have been and still are the most vigilant
- ▶ Compliance department should be closely monitoring controls and activity
- ▶ Enforcement actions split between KYC and AML
- ▶ Enforcement schemes:
 - One off – letter or warning letter
 - Consistent control violations – fine
 - Systemic violations – big fine!
 - Continuous violations – sanctions and deferred prosecution agreement

Enforcement Actions

- ▶ Most enforcement actions are against the banks
 - FCMs/BDs are subs of bank under same control structure