

Conference Paper

Rules of Internal Control of the Broker as a Tool for Risk Management of ML/FT

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Abstract

The article analyzes and identifies the features of a brokerage company as an economic entity, identifies the main risks of a broker in the sphere of ML/FT, and examines the rules of internal control and the requirements imposed on them.

Keywords: internal control, broker, risks, economic security

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1. Introduction

This article provides an overview of the concept and essence of the ML/FT risk classification, the impact of these risks on financial institutions, institutions, and the state. The advanced and most relevant approaches to the classification and risk assessment are considered, the features of the brokerage company's economic and operational activities are analyzed, the main risk categories in AML/CFT.

2. Internal Control for AML/CFT Purposes

Internal control for AML/CFT purposes is an integral part of the organization's overall internal control system. The main task of internal control is to monitor compliance with the requirements of legislation, including licensing requirements, when the organization conducts economic activities. In addition, internal control is aimed at identifying and preventing violations in the activities of the organization, as well as identifying the causes and perpetrators of such violations.

The lack of a well-developed internal control system or insufficient level of its effectiveness leads to violations of the law, which in turn leads to the potential involvement of the organization and its managers in administrative or criminal liability, the consequences of a legal nature in the form of suspension or withdrawal of a license,

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qualification certificates of officials of the organization, exceptions to the relevant registers of financial companies, as well as to reputational risks.

All this shows the excessive importance of a well-designed and comprehensive system of internal control and ensuring a high level of its effectiveness. Internal control in the organization is carried out through [1]:

1. internal documentation;
2. the choice of persons who will be responsible for compliance with the policy;
3. risk management;
4. implementation of a policy of personal responsibility of employees for compliance with AML/CFT policy;
5. development of algorithms for eliminating conflicts of interest;
6. building communication channels between employees and management;
7. segmentation of all powers and responsibilities of employees in the field of monitoring;
8. implementation of the policy of internal training and professional development; and
9. allocation of responsible specialists for training new employees in domestic AML/CFT policy.

In accordance with the developed laws in the RF in the field of AML/CFT, organizations that carry out transactions with money or other property (hereinafter – supervised organizations) are obliged to:

1. independently develop internal control rules based on AML/CFT legislation and periodically update the rules in the framework of changing or updating the laws;
2. appoint an employee from the state who will be responsible for the implementation of internal control rules for AML/CFT purposes. A dedicated employee should be responsible not only for developing the internal control policy but also for its constant updating. The responsible employee should form an internal control department and conduct integrated training of employees;
3. register with the Federal Financial Monitoring Service (Rosfinmonitoring);

4. prior to the beginning of operational interaction with the client, to carry out the identification of clients of both individuals and legal entities. Financial and broker companies are required to produce documents identifying the identity and source of origin of the funds being invested or transferred;
5. to identify, record and transmit to Rosfinmonitoring information on all transactions that are subject to mandatory control;
6. provide Rosfinmonitoring upon request with information about clients, their operations and beneficiaries;
7. block and freeze investment or cash accounts of individuals and legal entities, if they fall into the list of extremist activities or terrorism, by submitting this information to Rosfinmonitoring;
8. constantly, but at least every 3 months, check their customers for getting into the list of companies or individuals who are recommended to be blocked or strengthened;
9. pay special attention to monitoring the operations of persons who are affiliated with persons or companies that are registered in the countries included in the list of offshore countries or countries that do not comply with the FATF recommendations;
10. regularly classify clients by the level of risk in the AML/CFT area and apply analysis and monitoring tools to high-risk client groups;
11. conduct mandatory internal and external training for AML/CFT employees in the form of courses, lessons, briefing, advanced training (level of knowledge) and on-site trainings;
12. at least 5 years after the termination of business relations with the client, store documents and any data provided by the client: passport data, documentation of sources of income, certificates from the place of work, extracts from bank settlement accounts, and so on. To observe the strict regime of confidentiality of personal data storage during the implementation of the rules for the purposes of AML/CFT documents and information;
13. regularly audit the effectiveness of the internal control policy and improve the algorithm of the company's financial monitoring department; and
14. register in the Rosfinmonitoring portal and get access to your Personal Account.

To conduct more effective internal control for AML/CFT purposes, it is also necessary to have and periodically update the following data [2]:

1. a list of terrorists and extremists, which is regularly updated and placed in the personal office of Rosfinmonitoring;
2. a list of states that do not comply with the recommendations of the FATF, approved by the Order of Rosfinmonitoring of November 10, 2011, No. 361 «On the definition of the list of states (territories) that do not comply with the recommendations of the Financial Action Task Force (FATF)». Currently, it includes the Islamic Republic of Iran and the Democratic People's Republic of Korea (DPRK);
3. the list of offshore states approved by the Order of the Ministry of Finance of the Russian Federation of November 13, 2007, No. 108n «On approval of the list of states and territories that provide preferential tax treatment for taxation and (or) do not provide disclosure and provision of information for financial transactions (offshore zones)».

3. AML/CFT Rules for a Brokerage Company

The broker's activity consists in execution of orders and instructions of the client for fulfillment of investment and speculative transactions with securities or for the conclusion of contracts that are derivative financial instruments. To fulfill his duties, the broker must sign a contract with the client.

A broker is a qualified intermediary between a group of investors and a stock or currency market and provides advisory and investment services for a fixed or rolling commission, which is determined by the format of the contract with the broker.

On July 15, 2015, the Central Bank of Russia posted information and methodological recommendations No. 18-MR. In that, the CB puts the attention of brokers and the management of investment companies on particularly controlled transactions and transactions of their clients. The Central Bank notes that as a result of conducting its own control and supervision activities, cases are revealed of the systematic commission by unscrupulous clients of brokers and their direct counterparties of transactions with securities that do not have an obvious and understandable economic sense at first glance. The potential purpose of such operations can be legalization (laundering) of proceeds from crime, financing of terrorism, cashing out illegally obtained income and avoiding taxation and other illegal purposes.

According to the Central Bank, as a rule, clients tell their brokerage company to purchase foreign securities from a non-resident or a Russian credit organization (e.g., shares of foreign companies, foreign bonds, ETF and other indices), where the securities are held by a foreign depository, and these operations of buying, selling or disposing are characterized by several of the following features:

1. operations to acquire assets are conducted regularly (several times a week and more often);
2. all operations are strictly one-sided. Shares, bonds and assets can only be bought or, vice versa, only sold;
3. the alienation or sale of securities purchased by the client is effected by non-residents on the terms of payment «free of payment», but instead of timely payment of the counterparty's assets being alienated, a counter offer of other assets that may be goods imported into the Russian Federation from the member states of the Customs Union is issued. The practice of offsetting counter claims for the payment of works already performed or services already provided is widely used. Earlier, schemes with the transfer of securities were actively used especially at the expense of their sale by installments or with a significant deferral of payment, or in terms stipulated by the terms of the transaction, under which the real payment of securities by the buyer is not made at all.

Particularly controlled transactions can be considered transactions that are carried out by the broker and serviced by the broker's people, and by the nature of the counterparties, these transactions take place with legal entities:

1. The authorized capital of a legal entity is equal to or slightly higher than the minimum amount of the authorized capital required for the establishment and registration of a legal entity;
2. the founder of a legal entity is the chief accountant in combination;
3. the founder of a legal entity is the founder of several other legal entities;
4. the address of registration (location) of the legal entity and its executive management body is located at the address of mass registration of legal entities. Mass registration address is the address where a lot of legal entities are registered on a strictly limited territory;
5. a permanent executive body of a legal entity or any other body or person who has all the rights to act on behalf of a legal entity without obtaining a power

of attorney is not present at the place of permanent location or registration, information about which is contained in the unified state the register of legal entities;

6. The Central Bank recommends that Russian brokerage companies (including Russian credit institutions) pay attention to transactions, turnover or trading volume without considering the leverage and/or commission that exceed 1,000,000 (one million) rubles in a day;
7. request data on clients and final beneficiaries, on whose behalf a counterparty broker acts. Within the framework of work with broker clients, the company should receive sufficient information about the ultimate beneficiaries of other professional participants of the securities market and investments;
8. in the event that the client-broker fails to provide information on the ultimate beneficiary of the purchase or sale of assets, and if the documents show that the client who is the broker acts on behalf of another broker, exercise the right to refuse the transaction specified in clause 11 Article 7 of the Federal Law of August 7, 2001 N 115-FZ;
9. to request from the client five days after the purchase on behalf of the client of securities of documents certifying the rights of a client who is not a broker or legal entities in whose interests the client being the broker acts on the securities purchased, as well as current for the date request documents on transactions made with acquired securities (for example, an extract from a depo account, a report on transactions with a depo account of the holder (nominal holder), etc.);
10. in the event that the customer submits statements or documents from which information follows that the securities within five days from the date of their purchase were alienated in favor of third parties, request documents confirming the real transfer of funds to the asset disposal transaction. In case of failure to provide extracts or non-confirmation by the documents of operations to receive funds for the transfer of assets or if it follows from the transferred documents that within five days of the acquisition of securities, these securities were alienated without actually receiving real funds for the securities being alienated, operations and further movements in the account, provided by N 115-FZ. Provide increased attention to all operations of such a client; in the long term;
11. send information to the authorized body on the operations of such a client that meet the criteria specified in this Methodological Recommendations, on the basis

of clause 3 of Article 7 of Federal Law No. 115-FZ, including using the codes of types of characteristics 3212, 3218, 3219, 3222 of the list of characteristics, indicating the unusual nature of the transaction contained in Annex 3 to Regulation No. 445-P;

12. The Bank of Russia recommends that brokers (including Russian credit institutions), in the framework of the program for managing the risk of legalization (laundering) of proceeds from crime and financing of terrorism, pay increased attention to treaties whose transactions can correspond to two or more criteria in If the turnover under these contracts exceeds (may exceed) 1 million rubles a day, and if there are suspicions that the possible actual goals of transactions under contracts may be legal (laundering) of proceeds from crime, financing of terrorism and other unlawful purposes, refrain from concluding such contracts with counterparties that are relevant to the characteristic (signs), as well as counterparties being brokers, and also include in existing contracts with these counterparties the conditions providing for the following rights of the broker;
13. request information from the counterparty being the broker about the persons on whose behalf the securities are purchased;
14. if the counterparty fails to provide the requested documents, and if the documents show that the counterparty being the broker acts on behalf of another broker, exercise the right to refuse the transaction;
15. to request from the counterparty, after five days from the moment of the operation on transferring funds to pay for the securities purchased from the broker, documents certifying the rights of a counterparty who is not a broker or legal entities in whose interests a counterparty being a broker acts on the acquired securities, as well as documents relevant to the date of the request for transactions made with acquired securities (for example, a statement on the depo account, a report on transactions on the depo account of the owner (nominal holder));
16. if the counterparty submits documents from which it follows that the securities were alienated within five days from the date of their acquisition from the broker, request documents confirming the actual transfer of funds under the transaction related to the alienation of securities to the counterparty's bank account, not a broker, of a legal entity on whose behalf a counterparty being a broker purchased securities;

17. in the event that the counterparty fails to provide the specified documents or submits documents, from which it follows that within five days from the date of purchase from the securities broker, these securities were alienated without actually receiving cash for the securities being alienated, to refuse to make subsequent counterparty transactions with external securities and (or) unilaterally terminate contracts that define the general conditions of the broker's relationship with the counterparty when making transactions for the sale of prices securities.

4. Rules of Internal Control of the Broker

Development, verification and updating of internal control rules for AML/CFT brokerage company in accordance with the requirements of Federal Law No. 39-FZ of April 22, 1996 «On the securities market» and Federal Law No. 115-FZ of 07.08.2001 «On combating the legalization (laundering) of proceeds from crime and financing of terrorism».

Internal control rules include the following forms of primary documents:

1. customer profile (physical person);
2. customer profile (legal entity);
3. customer profile (individual entrepreneur);
4. the questionnaire of the beneficiary (an individual);
5. the questionnaire of the beneficiary (legal entity);
6. the questionnaire of the beneficiary (individual entrepreneur);
7. the form of the client's representative;
8. Customer Benefit Profile; and
9. the client's questionnaire on the financial position and sources of income for investment and cash.

Documents prepared in the framework of the Regulations on the Requirements for the Rules of Internal Control of Non-credit Financial Organizations with a view to Counteracting the Legalization (Laundering) of Proceeds from Crime and Financing of Terrorism approved by the Bank of Russia on December 15, 2014 No. 445-P [3]:

1. job description of a special official;

2. an order appointing a special official;
3. an employment contract with a special official;
4. annual plan of internal control checks;
5. an order to initiate internal control checks;
6. the report of the special official on the results of the audit of the implementation of internal control rules, the requirements of Federal Law No. 115-FZ of August 7, 2001 «On Countering the Legalization (Laundering) of Proceeds from Crime and Financing of Terrorism» and the Bank of Russia regulations on AML/FT (sample filling);
7. regulations on the AML/CFT unit;
8. job description of a special officer – Head of the AML/CFT unit; and
9. an employment contract with the head of the AML/CFT unit.

Documents developed in accordance with the Instruction of the Bank of Russia of December 5, 2014 N 3471-U «On requirements for the training and education of personnel in non-credit financial organizations» [4]:

1. AML/CFT training and education program;
2. a program for training employees for AML/CFT purposes to conduct an introductory (initial) briefing;
3. a certificate of the employee's passage of training for AML/CFT purposes.
4. attestation sheet;
5. tests to check the knowledge of employees in the field of AML/CFT, as well as answers to the AML/CFT test;
6. an annual plan for testing the knowledge of employees in the field of AML/CFT;
7. the annual plan for the implementation of the AML/CFT staff training program; and
8. the order to approve the list of employees who must undergo mandatory training and education for AML/CFT purposes.

Documents prepared in accordance with the Instruction of the Bank of Russia No. 3484-U of December 15, 2014 «On the procedure for submission by non-credit financial organizations to the authorized body of information provided for by the Federal Law on Countering the Legalization (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism»:

1. the order on working with the lists of the Interdepartmental Commission for Combating the Financing of Terrorism;
2. an act on the results of the check on the list of persons whose property is frozen (blocked) by the decision of the Interdepartmental Commission for Combating the Financing of Terrorism;
3. a memo on the unloading of a new decision of the Interdepartmental Commission for Combating the Financing of Terrorism;
4. the register of incoming information from the Personal Cabinet of Rosfinmonitoring;
5. the order to approve the schedule for verifying clients on the List;
6. a report on the results of the audit among clients of organizations and individuals for which measures have been applied, or freezing (blocking) of funds or other property should be applied;
7. a memo on the unloading of the new version of the List;
8. the order to apply the new edition of the List; and
9. the instruction on work in the Personal office of Rosfinmonitoring.

The Bank of Russia recommends that brokers (including Russian credit institutions) implement the program for managing the risk of legalization (laundering) of proceeds from crime and financing terrorism by including in the existing contracts with these counterparties conditions that provide for the following rights of the broker:

1. to request information from the counterparty being the broker about the persons on whose behalf the securities are purchased;
2. if the counterparty fails to provide the requested documents, and if it follows from the submitted documents that the counterparty being the broker acts on behalf of another broker, exercise the right to refuse the transaction;

3. to request from the counterparty, after five days from the moment of the operation on transfer of funds to pay for the securities purchased from the broker of the securities, documents certifying the rights of a counterparty who is not a broker or legal entities in whose interests a counterparty being a broker acts on acquired securities, as well as documents relevant to the date of the request for transactions made with acquired securities (for example, a statement on the depo account, a report on transactions on the depo account of the owner (nominal Foot holder);
4. if the counterparty submits documents from which it follows that the securities were alienated within five days from the date of their acquisition by the broker, request documents confirming the actual transfer of funds under the transaction related to the alienation of securities to the counterparty's bank account, not a broker, of a legal entity on whose behalf a counterparty being a broker purchased securities; and
5. if the counterparty fails to provide the specified documents or submits documents, from which it follows that within five days from the date of acquisition from the securities broker, these securities were alienated without actually receiving cash for the securities being alienated, to refuse to make subsequent counterparty transactions with external securities and (or) unilaterally terminate contracts that define the general conditions of the broker's relationship with the counterparty when making transactions for the sale of prices s securities.

Summing up, it can be noted that the article examined the features of the brokerage company's operational activities, analyzed the risks of the broker in the sphere of ML/FT, their classification, and also considered advanced methods in AML/CFT monitoring.

References

- [1] Instructions of the Bank of Russia of January 29, 2018, No. 4707-U.
- [2] Order of Rosfinmonitoring dated November 10, 2011, No. 361 «On the definition of the list of states (territories) that do not comply with the recommendations of the Financial Action Task Force on Money Laundering (FATF)».
- [3] Bank of Russia Regulation No. 445-P of December 15, 2014 «On requirements for internal control rules of non-credit financial organizations for the purpose of



countering the legalization (laundering) of criminally obtained incomes and the financing of terrorism».

[4] Instructions of the Bank of Russia N 3471-U «On requirements for training and education of personnel in non-credit financial organizations» of December 5, 2014.