

# Source of Wealth & Source of Funds

Reflections by John Cusack, Global Head, FCC

Effective Customer Due Diligence is a core part of financial crime compliance. When it comes to higher risk, wealthy customers banks are now expected to take an enhanced approach and “reasonable steps” to understanding their source of funds and source of wealth.

Sources including the Financial Action Task Force (FATF), the Basel Committee on Banking Supervision (BCBS), the World Bank and the Wolfsberg Group acknowledge this need for Enhanced Due Diligence (EDD), particularly in higher risk situations.

However, there is little guidance available to help practitioners navigate real challenges in this space. Indeed, the World Bank has gone further and notes the lack of clarity of the meaning and application of terms and definitions; stating that “this leads to inconsistent EDD standards among banks.”

## What are Source of Wealth and Source of Funds?

Source material (see bottom of page 2.) defining these terms is available but limited. Nevertheless, based on these sources, natural working definitions we can build on are:

- **Source of Funds (SoF)** refers to the origin (i.e. how the funds being deposited with the bank were generated) but also includes the means of transfer of cash/deposits, precious metals or financial instruments deposited with a bank, focusing on the initial deposit amount and expected deposits during the business relationship.
- **Source of Wealth (SoW)** refers to the total wealth or the majority of the wealth of a customer, i.e. activities which have generated or contributed to a customer’s accumulation of funds and assets. SoW therefore describes how a customer acquired their total wealth over time i.e. the sources through which the wealth was generated.

## What are “reasonable steps”?

The bank’s verification or corroboration of SoW and SoF should be sufficient to form a reasonable belief that the customer has not earned or otherwise acquired their wealth or the funds to be deposited with the Bank from the proceeds of, or otherwise connected with, a predicate offence or criminal activity.

**Reasonable steps** should therefore be taken to collect information in order to understand and, where necessary, verify or corroborate SoF and SoW.

Figure 1. below illustrates how this forms part of the end-to-end EDD process.

Additional verification or corroboration of SoF may be required for customers such as wealthy Politically Exposed Persons (“PEPs”), or for those whom banks have reasonably determined to exhibit higher inherent financial crime risks.

In such cases, banks should validate expected SoF by comparing it against actual deposits made and by checking SWIFT messages or other receipts of funds.

The origin of the SoF and SoW can also be validated or corroborated using documentary sources such as:

- **Documents** received either from the customer directly, or from third parties on behalf of the customer or from third parties commissioned by the bank; and
- **Call reports** created after customer discussions or visits to customers business premises or properties.

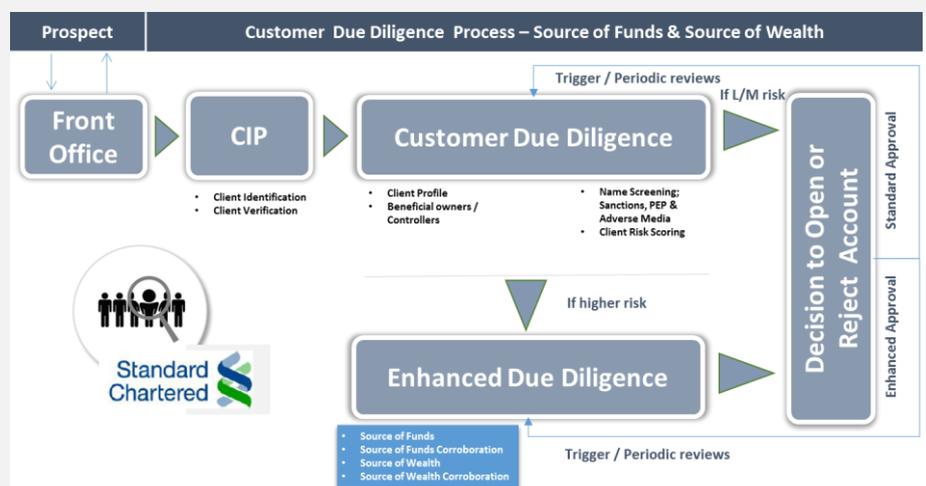


Figure 1. SoF and SoW and verification/corroboration as part of EDD Process

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#### Potential Challenges around SoF and SoW

Whilst understanding SoF and SoW is an important task in conducting EDD, it is very different, for example, from establishing a customer's identity, determining whether they are a sanctioned party, a PEP, or another person of interest. In these cases, the Policies and Procedures of Financial Institutions (FIs) can be quite prescriptive, rules-based and tested against clear expectations and outcomes, with a binary pass or fail.

However, in the case of SoF and SoW, whilst minimum standards can be prescribed and guidance (and training) provided, it is important to recognise that no two customers are likely to be the same and that the information readily available and of value will differ between customers.

As a result, there shouldn't be an expectation that, in applying the FI's EDD procedures, all customers will have the same level of information collected with regard to SoF and SoW. To illustrate, some customers may have banked with the FI for decades and so the Bank will have historic information in its own records, whilst newer customers may need to provide additional evidence.

Furthermore, whilst the level of risk should be the primary driver of the level of understanding and verification or corroboration of SoF and SoW required, it should be recognised that a customer who has transparent and relatively easily understood Wealth (for example, well known persons, long standing customers, employees etc.) will be less challenging to apply these standards to and will also require less verification or corroboration. Conversely, customers with higher risk, complex, or opaque wealth profiles should be the focus of more intensive focus and verification or corroboration.

#### Avoiding a 'check the box' approach

It is essential that judgement and reflection are applied when obtaining and trying to understand SoW and SoF information. Time should be invested before reaching a conclusion on whether the information provided makes sense and is plausible. This should never be a "check the box" or a "one size fits all" exercise.

Banks should provide relevant staff with the appropriate training and guidance to support them in understanding and these requirements, in addition to monitoring and testing of the effectiveness of this important control on an ongoing basis.

*"Understanding and recording SoF/SoW is not an easy task, outside of straightforward cases. In exploring existing published materials around this topic, there is space for much greater clarity. Whilst this paper attempts to offer additional guidance, it is hoped that this area can be further explored by interested parties, policy makers, regulators and within the wider banking industry."*

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