dutch banking association

Risk-based Industry Baseline

Source of Funds (SoF)

strong banks
strong society

Context

Introduction

The assessment of the Source of Funds (SoF) used in a business relationship or transaction is part of the Client Due Diligence (CDD) measures. This assessment of the SoF is to be conducted 'where necessary' according to Wwft article 3 sub 2d on ongoing monitoring. This means that the SoF assessment is done in a risk-based manner when there is for example an alert or event. It is therefore not necessary to assess the SoF for all clients or transactions. The same applies at onboarding: an assessment of the SoF related to the business relationship or transaction is only necessary when it is risk relevant.

The assessment of the SoF used in the business relationship or transaction should be conducted in a money laundering or terrorism financing (ML/TF) risk relevant manner. This means that when banks are exposed to ML/TF risks during a business relationship, these risks should be managed and mitigated by applying a risk-based assessment of the origin of the funds related to the business relationship or transaction.

The extent and application of the SoF assessment can be adjusted proportionate to the identified risks and taking into account the specific circumstances of the business relationship or transaction. How the nature and depth of the SoF assessment is recorded can differ per bank. For most clients (such as mass retail clients), the SoF will generally not be assessed at onboarding. Where the client segment is recorded in the client file and the reasoning for the SoF assessment is applied in accordance with the policies and procedures, there is no need to record this explicitly in the individual client files.

The SoF assessment is to be done in a client-centric way, where the SoF is one element of the holistic risk assessment of a client. This also means that the SoF assessment does not concern assessing a third party's SoF, provided there are no risk triggers which would require assessment of that specific party. For instance, in case a client receives an inheritance, banks are generally not required to assess the origin of the testator's funds (or wealth).

Whether to obtain additional information or evidence should be concluded on a risk relevant basis and contribute to assessing and mitigating perceived risks. In general, information of the SoF will be obtained through a sequential three-step approach, with each next step only taken if necessary.

1 Desk research by means of external sources and/or internal analysis.
2 Client contact and outreach.
3 Obtaining additional documentation.

This NVB Industry Baseline describes the risk-based Dutch banking practice to implement the SoF requirements for low, neutral and high risk scenarios. The indicated risk level of a scenario should be interpreted in the full context of the client, in this case with focus on the specific SoF related risks.

Positioning within the Financial Crime Framework

The assessment of the SoF is part of the CDD measures and is conducted when there are alerts or events that warrant further assessment of the SoF, either at onboarding or during the relationship.

Financial Crime Framework

Risk-based

Client onboarding

ID&V, incl UBO
Art. 3 + 33 Wwft

Sanction screening
Art. 2 RTSW

PEP screening
Art. 8 Wwft

High risk geographies
Art. 8 + 9 Wwft

Purpose & nature
Art. 3 Wwft

Source of wealth
Art. 8 + 9 Wwft

Source of funds
Art. 3 (2)(d) + 9 Wwft

Client risk assessment
Art. 3 + 33 Wwft

Client data

Required data natural person (illustrative)

- Names (first + middle + last)
- Date of birth
- Residential address
- ID doc: type, number, date, place
- Representative see above + mandate

Required data legal entity (illustrative)

- Legal form
- Statutory name
- Trade name(s)
- City, street, number
- Country of incorporation
- Registration number
- Business activities
- UBO: names (first + middle + last), size and/or nature beneficial relationship
- Representative: names (first + middle + last), date of birth, authority to represent

Ongoing due diligence

Sanction screening	PEP screening	High risk geographies	Source of wealth	Source of funds	Detecting unusual behaviour (TM)	FIU reporting	Actualisation client data
Art. 2 RTSW	Art. 8 Wwft	Art. 8 + 9 Wwft	Art. 8 + 9 Wwft	Art. 3(2)(d) + 9 Wwft	Art. 2 + 3 + 8 + 9 + 16 + 23 Wwft; Art. 14 Bpr	Art 16 Wwft	Art. 3 + 8 Wwft Art. 14 Bpr

Client data

- Data natural person
- Data legal entity

Alert and event generation Baseline Event categories

In line risk assessments (incl. SIRA): • Client risk • Geographical risk • Product/services risk • Channel risk • Transaction risk

Client filtering | Transaction filtering | Transaction monitoring | Client monitoring | Other triggers

Trigger-based alert/event

Time-based

Alert/event handling triage

Review of alert/event and/or (if needed) CDD

(If needed) CDD

Follow-up on CDD (Filing UAR to FIU and/or taking mitigating measures and documenting & closing alert/event)

Exit

Exit
Art. 5 Wwft

Exit

Regulatory requirement
Risk detection mechanism

Risk-based Industry Baseline

1 Definition of Source of Funds

The EBA has defined 'source of funds' in the ML/TF Risk Factors Guidelines as "the origin of the funds involved in a business relationship or occasional transaction. It includes both the activity that generated the funds used in the business relationship, for example the client's salary, as well as the means through which the client's funds were transferred." The FATF (in its guidance on PEPs) uses a similar definition referring to the origin of the particular funds or other assets which are the subject of the business relationship between the client and the financial institution.

1.1 Relationship with Source of Wealth

The EBA ML/TF Risk Factors Guidelines state 'source of wealth' to mean the origin of the client's total wealth, for example inheritance or savings. The FATF guidance on PEPs provides the following definition: "The source of wealth refers to the origin of the PEP's entire body of wealth (i.e., total assets). This information will usually give an indication as to the volume of wealth the customer would be expected to have, and a picture of how the PEP acquired such wealth."

For some clients, the assessment of the SoF may generate sufficient insight into the SoW as well. This can for instance be the case for PEPs and certain high risk clients or Ultimate Beneficial Owners (UBOs). If the assessment of the PEP's SoF results in sufficient comfort and there are no risk indicators, the SoF assessment may generate sufficient insight into the SoW as well. Whenever the SoW of a client is assessed, this will also cover assessment of the SoF.

Furthermore, it is not always necessary to assess the SoW of a client solely because they acquire characteristics of a private banking client or reach a threshold to be considered a high-net-worth individual during a long standing business relationship. In such situations, reliance can be placed on the internally available information, provided that this information is up to date.

Similar as the definition of SoF, SoW is also interpreted in a client-centric way, meaning that it is not required to assess the SoW of a third party from whom the client for instance inherits wealth (provided there are no risk triggers).

2 Industry Baseline

For banks, it is important that the ML/TF risks related to the origin of the funds are assessed and mitigated where necessary, especially when there is no plausible explanation. This means that where a potential risk related to a client or transaction is detected the mitigating measures should focus on that specific risk.

2.1 Source of Funds assessment at onboarding

Assessing the SoF is warranted only when specific circumstances call for it. Such assessment becomes relevant and essential if an alert or event indicates potential ML/TF risks. Hence, if there are risk indicators associated with a client, such as indications that the SoF might be illicit, this should be a reason to obtain information on the SoF at onboarding. For most clients, however, that will not be the case during the onboarding process. This is aside from those situations where, based on a legal requirement, e.g. when the client is a PEP, adequate measures regarding the SoF (and SoW) must be taken based on the risks involved.

For combinations of client type and product type where the risk scenario is assessed as low or neutral risk, such as current accounts and/or savings accounts for retail clients, assessing the

SoF is not necessary prior to client acceptance, unless risk indicators are present.

For certain combinations of client type and product type assessed as higher risk scenario, banks may decide based on risk indicators, such as known adverse media, that an assessment of the SoF is necessary prior to starting the business relationship. These risk indicators may also guide banks in determining the intensity of the initial assessment.

The objective of the SoF assessment for banks is to be satisfied that the funds involved in the business relationship or transaction do not originate from illicit sources. For the SoF assessment, information can be obtained via the three-step approach described above. The information obtained should be plausible and explain the origin of the funds. If there are doubts about the explanation or if the obtained information is not sufficient to mitigate the perceived risks, additional research is required, and where necessary, the information should be substantiated with reliable documentation.

If general information on the client's income or employment status is obtained at the time of onboarding, this can provide some insight into the client risk profile, however, the information is only a snapshot at that point in time and can become outdated. Client information is to be updated as part of the ongoing monitoring process.

2.2 Source of Funds assessment during the relationship

During the life cycle of the client, banks conduct ongoing monitoring, which amongst others consists of adequate Client Monitoring (CM) and Transaction Monitoring (TM) processes. These processes consist of a time-based and/or trigger-based framework as part of which banks detect risk indicators that call for an assessment of the SoF. Such a trigger can for instance be unexplained changes in the expected transaction behaviour, e.g. repetition of the same type of transactions and amounts.

In case of risk indicators, banks assess the SoF to determine whether there is a logical and plausible explanation for the funds. In line with the three-step approach described above, banks assess the gathered information.

A transaction within the business relationship may trigger an assessment of the SoF of that transaction. However, the assessment of obtained information for that transaction should be made holistically, in the context of the overall business relationship.

If a client's SoF has been recently assessed and the information is still current, and a new alert or event aligns with the expected transaction behaviour, there is no need to re-obtain information and evidence of the SoF.

In case the outcome of the assessment does not mitigate the identified risks, this can result in different follow-up actions, such as adjusting the risk classification of the client, increased monitoring, offboarding the client and/or filing an unusual transaction report with the FIU.

2.3 Examples of documentation on source of funds

When assessing the SoF (or SoW), information or, if applicable, documentation to be obtained should explain the activities that generated the funds. Depending on the information obtained, some – non-exhaustive – examples of documents that can be used are:

- i copy of a recent payslip;
- ii annual salary statement from an employer;
- iii annual accounts of a company (in combination with a tax return);
- iv copy of a contract of sale of, for example, investments, a company or a valuable object;
- v loan agreement signed by all parties;
- vi settlement bill for the sale of real estate or other property by a notary;
- vii notarial deed regarding an inheritance;
- viii settlement agreement of an insurance company;
- ix open source of a company registry to confirm the sale of a company;
- x tax returns.

3 Impact

By applying the sequential three-step approach for obtaining information on the SoF, the impact on the client will be minimized, especially in low and neutral risk scenarios. Client outreach will be limited in these cases, and requesting documentation from the client will only be required in case of doubts.

Outreach to a client is generally seen as disproportionate and often experienced as unnecessary and burdensome for both clients and banks. Relying in low and neutral risk scenarios on available and up-to-date information is in accordance with the risk profile of these clients. The administrative burden for clients and banks is reduced and less intrusive when client outreach is not needed. However if information is not sufficiently available or the transaction cannot be explained, client outreach is needed.

4 Use cases

The use cases below are examples to illustrate a practical application of this Industry Baseline and is not intended to be exhaustive. These use cases are based on low, neutral and high risk scenarios to assess the SoF at onboarding and during the business relationship.

Low risk

Example

A client (40 years old) wants to open a savings account at a bank. The initial deposit of €50k is transferred via the bank account of the client at another Dutch bank. This account at the other Dutch bank is the designated counter account. There are no risk indicators on the client.

Industry Baseline

- Since there are no risk indicators, no SoF assessment is necessary prior to entering into the business relationship.

Low risk

Example

An SME business client active in the Netherlands and Belgium has a bank account at a Dutch bank for more than five years. Incoming transactions from the Netherlands and Belgium range from €500–30k. A transaction of €50k is received from a French company.

Industry Baseline

- Desk research is done to establish the link between the client and the French company.
- If sufficient information is obtained from the desk research, steps 2 and 3 are not necessary.

Low risk

Example

A listed corporate client wants to open a payments and cash management account. This is necessary for the client's business activities in the Netherlands.

Industry Baseline

- Desk research is done to establish that the client is listed and that an annual report is available.
- If sufficient information is obtained from the desk research, steps 2 and 3 are not necessary.

Neutral risk

Example

A Dutch client opens a private banking account and transfers €5m from a Dutch bank account. At onboarding, there is client outreach after the desk research.

Industry Baseline

- As part of client outreach, the client explains he has sold 100 garage boxes that he bought a long time ago and invested the revenues from the sale in real estate. He also indicates prior to that he sold his business in 1985.
- Desk research (media and real estate register) shows no risk indicators and the value increase of the investments is deemed plausible.
- Explanation obtained from the client and supported with further desk research is sufficient.

- No need to further investigate that sale of the business in 1985 and no need to obtain additional documentation.

Neutral risk

Example

A client receives payment of €200k from the Qatar through a funds transfer.

Industry Baseline

- As part of client outreach, the client explains that it concerns a gift from his mother who sold her business in the Netherlands and moved to Qatar.
- The client provides evidence to show the transfer was indeed from his mother.
- Desk research shows the mother was an entrepreneur who sold her business for a substantial amount.
- Information from the client, evidencing that the funds were transferred from his mother and desk research is sufficient.
- Further documentation on the SoF is not proportionate.

Neutral risk

Example

A client (Chinese student in the Netherlands) receives €80k from China in her bank account. There are no risk indicators on the client. Client outreach took place because the transaction was outside the expected transaction behaviour.

Industry Baseline

- As part of client outreach, the client explains it is a gift from her parents in China.
- The client provides evidence to show the gift indeed came from the parents.
- Explanation from the client supported with the evidence is sufficient.
- It is not necessary to assess SoF or SoW of the parents.

High risk

Example

A new private banking client who has structured his wealth using a STAK will deposit €20m via various corporate accounts. As part of the holistic risk assessment, a SoF and SoW assessment was performed.

Industry Baseline

- The structure is a trigger to assess the SoF in combination with SoW.
- As part of the client outreach, information (such as audited annual accounts) is obtained and assessed.

High risk

Example

A corporate client with global activities, in a high risk sector and in high risk countries, requests a new loan facility. The country is not designated by the EC as high-risk third country.

Industry Baseline

- The activities in a high risk sector and in high risk countries were already a trigger to assess the SoF at onboarding.
- Specific information about the SoF for the new loan facility is only needed if the previously obtained data and desk research does not provide sufficient information.
- As part of client outreach, information such as audited annual accounts are obtained and analysed to determine whether the business activities and the income in the account match.

Context

Regulatory framework

The regulatory context for this topic is described in relevant parts of applicable laws, regulations and guidelines from various authorities, such as: FATF, EBA, Ministry of Finance and DNB. Below an overview of the current regulatory framework with reference to source of funds.

- **FATF Recommendation 10**
  "The CDD measures to be taken are as follows: (d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds."
- **Article 13 Revised 4AMLD**
  "Customer due diligence measures shall comprise:
  (d) conducting ongoing monitoring of the business relationship including scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the obliged entity's knowledge of the customer, the business and risk profile, including where necessary the source of funds and ensuring that the documents, data or information held are kept up-to-date.
- **Wwft article 3(2)d**
  "Client due diligence enables the institution to: d. conduct ongoing due diligence over the business relationship and the transactions carried out during that relationship to ensure that they are consistent with the institution's knowledge of the customer and its risk profile, and where necessary, with an investigation into the source of funds used in the business relationship or transaction."
- **Explanatory Note (Kamerstukken 33238, nr. 3, p.12)**
  "Specifically, the said investigation can thus be limited to the origin of the funds used; the other components of the client's assets can be disregarded. The phrase "where necessary" is taken from Article 8(1)(d) of the Third Money Laundering Directive and implies a risk-based assessment by the institution.
- **DNB Leidraad, paragraph 4.7** [1]
  "To determine the plausibility that the funds originate from a legal source, the institution must identify specific indicators which determine the depth of the review."

1 This is based on the DNB Leidraad of December 2020. At the time of publication of this NVB Industry Baseline, DNB was in the process of drafting the new Good Practices and Q&A.

Relationship between 'DNB Good Practices' and 'NVB Industry Baseline'

DNB aims to illustrate its supervisory practices to the benefit of supervised entities by, for example, providing an interpretation of regulatory requirements (Q&As) and examples on how regulatory requirements can be met (Good Practices). It is important to note that neither the DNB Q&As nor Good Practices are legally binding.

The NVB Industry Baseline describes the application and execution of the risk-based approach regarding assessing the SoF. Moreover, the Industry Baseline provides scenarios where the SoF needs to be assessed and where it may not be needed.

This NVB Industry Baseline must be read in conjunction with other Industry Baselines. The NVB Industry Baseline on politically exposed persons (PEPs) provides guidance on the Enhanced Due Diligence (EDD) measures regarding PEPs, including the assessment of their SoF and Source of Wealth (SoW). The NVB Industry Baseline on EDD measures in relation to EC High Risk Third Countries also addresses SoF and SoW requirements.

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