**2017 Edition**

**Policy paper concerning compliance risk management associated with Anti-Money Laundering (AML) and Combating the Finance of Terrorism (CFT)**

# Background and Definitions

## The Prohibition on Money Laundering Law 5760-2000 and the Combating Terrorism Law 5776-2016, along with all related ordinances, orders, rules and instructions issued by the competent authorities, obligate the bank and its subsidiaries to take steps, in accordance with Israeli and Western AML and CFT standards, to join the global struggle against money launderers and terror financiers, with the aim of preventing the bank and its services from being exploited by its customers for prohibited activity. The said forbidden activity is an activity or set of activities that constitute a process by which “prohibited property”, originating in an offense, to include serious tax offences, as defined in Paragraph 17a of the first amendment to the Prohibition on Money Laundering Law, may shed its criminal status, masquerading as completely legitimate property. These obligations also include following standards designed to cope with cross-border risks, including risks, rules and requirements stemming from statements issued from time to time by the competent authorities in the State of Israel, and by foreign states and authorities, such as the provisions of FATCA , which the United States government issued, standards determined by the OECD, compliance with Israeli tax law, and orders setting specific sanctions publicized by the said foreign states and authorities. In this document, the use of the term “money laundering”, including the dealings of the bank’s subsidiaries, is meant to encompass the handling of all of the items listed in this paragraph, unless the context of the text implies otherwise.

## AML and CFT risks are manifested, inter alia, in the bank’s exposure to fines and financial sanctions by the competent authorities in Israel, primarily the Supervisor of Banks, to fines and financial sanctions by foreign authorities, and to taking part in criminal activity as a result of a violation of legal provisions in the area of AML. Moreover, the bank is exposed to reputational risk and its relationship with other entities may be compromised due to money laundering activities its customers may be involved in. It is exposed to legal risks stemming from lawsuits and damage that may be incurred due to the said activities. These violations may be caused by a lack of professional counseling and adequate enforcement with regard to the existence and interpretation of relevant legal provisions.

# Compliance risks associated with AML and CFT stem from the following main sources:

## Bank activity that does not comply with legal provisions, regulations and court rulings concerning AML and CFT.

## Money laundering events in which the bank’s customers may be involved, such as negative publicity on the bank that implicates it in money laundering scandals.

## Significant legal proceedings which the bank is party to, such as seizure of property and finances considered to be prohibited property, whereby the bank is required to demonstrate that offset or pledge rights had been purchased in good faith, and that the bank could not have known that the property had been used or acquired illegally.

## Bank activity inconsistent with legal provisions and regulations set by the competent authorities in Israel and/or in foreign states, which apply to specific bank customers, including taxation aspects.

# Goals and objectives tied to the management of risks associated with AML and CFT:

The goal of the management of compliance risk associated with AML, CFT and “know your customer” (KYC) is minimizing the said risk, aspiring to prevent the creation or materialization of the said risk, and creating a safe work environment in terms of compliance for the bank’s regular business planning and management activities, with an emphasis on the following:

## **Ensuring compliance with legal provisions -** conducted in accordance with legal provisions concerning AML and CFT and compliance with the said provisions, while maintaining regular and productive cooperation with the competent enforcement authorities, while adjusting to international standards and global developments, based on consultations with those responsible for this topic at the bank.

## **Professionalism** **-** ensuring proper business activity conducted by a clientele whose business dealings are lawful. Abstaining from participation in any of its customers’ unlawful activities, while minimizing exposure to other risks that may be generated by the said activities.

## **Ethics *-***adopting the ethical norm of the international struggle against money launderers and terror financiers, while committing to implementing relevant regulations, among which are binding ‘know your customer’ regulations.

# The organization’s responsibility and commitment - overview

The policy paper on the management of compliance risks associated with AML, CFT and KYC expresses the commitment undertaken by the board of directors, the management, the officer responsible for fulfilling requirements under the Prohibition on Money Laundering Law and his/her subordinates, the AML unit, the committee for examining reports on irregular activities, and compliance trustees in the bank’s units and branches, to manage these risks wisely. The AML risk management governance structure at the bank is comprised of three lines of defense:

1. The first line of defense: the management of the business line.

2. The second line of defense: an independent function for risk and control management.

3. The third line of defense: internal audit.

The compliance function, along with the AML unit it contains, is part of the bank’s second line of defense for risk management, and it interacts with the other lines of defense which participate in the implementation of the principles set in this policy paper.

## **The roles of the board of directors**

* Approving policy on meeting AML, CFT and KYC obligations.
* Determining the bank’s overall risk appetite and tolerance for AML and CFT.
* Upholding the bank’s policy, in accordance with varying regulatory requirements concerning AML and CFT.
* Discussing the AML and CFT compliance risk map and the process of generating lessons learned from the materialization of these risks, if any, at the rate of at least once a year.
* Discussing the bank’s policy on these issues at least once a year, and updating the policy paper as necessary.
* Ensuring that the AML/CFT framework and compliance risk management process are subject to the review of an internal auditor, and that they will be incorporated into the internal auditor’s multi-year work plan.

## **Roles of the management**

* Taking steps meant to stress its commitment to implementing the policy approved by the board of directors, to include ensuring that proper procedures for the implementation of this policy are in place.
* Deepening managers’ and employees’ awareness of the various lines of business, which constitute the first line of defense, in order to manage AML/CFT risk compliance.
* Ensuring that the organizational structure (commercial and operational), headed by the officer responsible for fulfilling obligations to oversee AML efforts, supports the implementation of AML/CFT policy.
* Ensuring that the officer responsible for fulfilling obligations under the Prohibition on Money Laundering Law and his/her subordinates, who constitute part of the second line of defense, rapidly receive any information on suspicious or unusual activities and transactions, or any other significant information on money laundering or terror financing, as well as the tools and assistance they need to fulfill their roles and handle the areas under their responsibility.
* Ensuring that adequate controls exist for work processes.
* Receiving a report on the AML/CFT compliance risk map and on the physical materialization of risks and damages (hereinafter: “Assessment Report”), discussing its findings, generating lessons learned, determining ways to handle the situation based on the recommendation made by the Officer, and reporting to the board of directors on these matters.
* Discussing events and developments with implications for AML/CFT in Israel and in the world, and assessing the need to report any such events to the bank’s board of directors, as well as discussing lessons learned and their implementation at the bank.

## **The roles of the officer responsible for fulfilling obligations under the Prohibition of Money Laundering Law**

The chief compliance officer has been appointed the officer responsible for fulfilling obligations under the Prohibition on Money Laundering Law (hereinafter: “the Officer”), and his/her roles and responsibilities are as follows:

* Ensuring the regular implementation of the bank’s and its subsidiaries’ various legal obligations, and implementing the board of directors’ policy and directives concerning AML and CFT.
* Overseeing the work of the AML unit with respect to how the bank and its subsidiaries fulfill their obligations pertaining to AML and CFT.
* Submitting an annual assessment report to the bank’s management, the board of directors, the board of directors’ risk management committee, and/or to any other committees appointed by the board of directors, which had been delegated the authority of deliberating and reaching decisions concerning compliance and regulations. This report shall cover the implementation of the bank’s policy and directives concerning AML and CFT, and shall be submitted at least once per year.
* Reporting to the CEO before the bank commences any new activities, and before a new consumer protection directive is issued, regarding actions that must be taken to achieve AML and CFT compliance.
* The Officer or any of his subordinates serves as the bank’s reporting officer for FATCA purposes.

## **The roles of the AML/CFT unit**

The AML unit, which is subordinate to the compliance branch of the legal counsel and compliance division, is responsible for assimilating the bank’s AML/CFT policy among all bank employees, and enforcing compliance in this area. The following is a list of the unit’s responsibilities:

* Providing support and professional counsel to all bank units and subsidiaries regarding AML and CFT.
* Bring about the identification and evaluation of activities suspected of contravening AML/CFT laws, determining whether an unusual or suspicious activity it was notified of requires it to report the unusual activity to the Israel Money Laundering and Terror Financing Prohibition Authority and submitting the necessary reports.
* The head of the AML unit shall also head the unusual activity reporting committee, and shall be responsible for convening the committee, for its meetings, for preparing the reports, and for submitting the reports to the Israel Money Laundering and Terror Financing Prohibition Authority.
* Setting internal AML/CFT rules and regulations, in accordance with the bank’s policy, adapting the bank’s legal documents to the relevant requirements, and updating them as required.
* Conducting regular AML/CFT audits.
* Ensuring that the bank’s employees have received sufficient training on their obligations and on the bank’s rules and regulations concerning AML and CFT, and bringing about the preparation and execution of training programs, in partnership with the bank’s training and organizational development branch.
* Determining and implementing work processes for regularly identifying and collecting all new legislation, directives, orders, bills and memoranda, orders and draft orders issued by the Bank of Israel, the Supervisor of Banks and the Israel Money Laundering and Terror Financing Prohibition Authority, orders of any other Israeli competent authorities and relevant orders issued by competent authorities outside of the State of Israel, rulings tied to banking, rulings tied to the bank in relation to the prohibition of money laundering, terror financing and KYC rules, including said arrangements under Israeli law concerning laws, standards and regulations determined by foreign states and authorities, or those stemming from them, as stated in Paragraph 1.1 above (hereinafter: “**Legal Provisions**”, and notifying the competent organs of events and developments tied to the prohibition on money laundering and terror financing in Israel and abroad, which should be evaluated to determine whether lessons can be learned and implemented at the bank, as close as possible to the time the said events or developments occurred or are publicized, as the case may be, and suggesting any appropriate changes to the bank’s policies and regulations.
* Representing the bank before all competent authorities and any third party vested with investigative authority, or one that contacts the bank on AML or CFT matters, and responding to requests for information submitted by the competent authorities.
* Representing the bank at external forums, the Bank of Israel, Knesset committees, government offices, and various authorities, in legislative proceedings or proceedings involving orders issued by authorities. Reporting to the Supervisor of Banks on special events, including those already reported to the Israel Money Laundering and Terror Financing Prohibition Authority, in accordance with legal provisions, and submitting outstanding reports to the Supervisor of Banks, as required under law.
* Submitting an annual assessment report on the implementation of the bank’s KYC policies and regulations to the bank’s management, which should include information on assimilating the requirements arising from laws, directives, and orders into the bank’s regulations, as well as a map of compliance risks in this area, lessons learned, and recommendations for follow-up actions.
* Representing the bank at meetings and in communication regarding subjects that the unit is responsible for, working with other banks that provide services to the bank (such as correspondent and custodian banking services).
* Implementing the compliance risk management policy determined by the board of directors, by, inter alia, coordinating between the various departments of the bank that are supposed to support the implementation of the compliance risk management policy with regard to AML and CFT.
* Ensure that all of the bank’s divisions comply with the bank’s AML/CFT policy and regulations.

## **Committee for evaluating reports on unusual activities**

The committee will be comprised of the director of the AML unit, AML unit employees (as per the team determined by the unit manager), the manager of the retail department, a representative from internal auditing (with observer status), and a representative of the business department.

The Officer shall be permitted to participate in the meetings, at his/her discretion.

The following is a list of the committee’s areas of responsibility:

* Evaluating reports on unusual activities and deciding which types of reports will be sent to the Israel Money Laundering and Terror Financing Prohibition Authority (hereby: “the Authority”), as required by law, and the manner in which reported accounts will continue to operate.
* Identifying AML/CFT risks and exposures arising from the reports on unusual activities, generate lessons learned from the reported events and subjects, and instructing the relevant parties on what the law requires.
* The director of the unit may, pending approval from the officer in charge of AML matters, convene the committee even if representatives from the business and retail departments are not present, provided that reports the committee decides not to send the Authority are reassessed by the committee in plenum.

## **The roles of the compliance trustees with regard to AML/CFT matters**

To ensure that bank employees implement legal requirements, compliance officers will be appointed at the bank’s branches and headquarters units, who are part of the first line of defense. Their areas of responsibility with regard to AML and CFT shall be as follows:

* Coordinating the handling of reports on unusual activities submitted by the branches, and forwarding them to the AML unit for further handling.
* Serving as a source of knowledge and as someone who can be consulted on emerging issues concerning the prohibition of money laundering and the financing of terror.
* Keeping abreast of new instructions and regulations publicized by the AML unit, participating in AML trustee conferences held at the bank, and transmitting content presented at the conferences to all bank employees.
* Conducting regular audits and elective audits, in accordance with the bank’s policies and regulations, and the AML unit’s instructions.
* Conducting orientation training for new employees regarding AML/CFT.

# Implementation methods in the organization

**The application of AML/CFT regulations and legal requirements pertaining to various bank activities shall consist of the following actions:**

## When **onboarding new customers**, the bank will run a comprehensive data verification and identification process and adhere to proper and thorough KYC rules, based on risk-based policies, whilst understanding the requested activity and determining whether it is being performed for other persons. The bank will consistently verify information on the scope and nature of the anticipated activity against the appropriate reference documents, and repeat KYC procedures, following a risk-based approach.

When onboarding new customers, the bank will require them to provide, inter alia, written letters of consent and declarations on the following matters:

### Waiving the confidentiality of the customer and information related thereto, so that it can be shared with the authorities in Israel and abroad.

### Obtaining the customer’s domecile/s for tax purposes.

### Verifying that the customer’s report on income fulfills all applicable laws.

### Requiring customers to notify the bank of any changes in tax liability.

If necessary, the bank should also obtain a confirmation that the customer had acted accordingly, or a confirmation that the customer had begun a disclosure process within the country the customer is domiciled in for tax purposes.

A hierarchy of authority shall be determined within the bank’s regulation for approving the opening of accounts, managing and executing transactions whose characteristics indicate a high AML risk, cross-border risks and risks pertaining to compliance with Israeli tax law, to include the conditions for refusing to open an account and continue managing it, for transactions including account withdrawals, attention to complex account ownership structure, unusual activities or behaviors associated with the account, and a change of account owners or beneficiaries.

This is designed to prevent the bank from exposing itself to risk whereby it is thought to have cooperated with the customer to circumvent a foreign law that applies to the customer.

## In terms of activities carried out remotely, including those activities executed over the internet, the bank will consistently conduct the proper identification and data security procedures. The bank will include restrictions on fund transfers made from the customer’s account in its regulations.

## The bank will intensify its efforts to recognize, define and locate **high-risk customers**, in terms of the prohibition on money laundering, compliance with Israeli tax law, or cross-border risks, and will adapt its KYC procedures to the various customer types. The following characteristics can indicate a high AML risk: providers of money changing services, accounts whose funds originate in donations, foreign residents, public servants, offshore companies, and diamond traders (the bank will conduct a more extensive KYC procedure for diamond traders, requiring them to produce a diamond trading license, assessing parties involved in diamond transactions, and more).

## The following characteristics can high risk indicators for cross-border risks, compliance risks, and tax-related money laundering: the source of wealth, the source of income or of money received from abroad, the customer’s association type, private banking, the customer’s ties with the country in which banking services are being provided, the customer’s domicile country, multiple citizenships or domiciles, or a change or concealment of a customer’s identification details which could influence the customer’s tax liability.

## The bank will prepare a list of countries (e.g. offshore countries) in which the customer’s activities, or transfers of funds from those countries, can indicate a high risk level with regard to cross-border risks and tax related compliance and money laundering risks.

## When dealing with these factors, the bank will bear in mind the following:

## A confirmation from any particular tax authority concerning the completion of a voluntary disclosure procedure does not derogate from the bank’s other AML-related obligations and does not confirm the legitimacy of a source of funds.

## Monetary thresholds used in determining serious tax fraud (see Paragraph 1.1 above) shall be considered a parameter in assessing the relevant compliance risk, but they will not derogate from the need to avoid conducting specific activities that seem suspicious or improper, or from the requirement to report unusual activity, even if the relevant amounts are below the said thresholds.

* The presence of complex ownership structures that make it difficult to identify a controlling shareholder, or customers using trusteeships that make it difficult to identify beneficiaries, specifically with regard to the purchase of real estate.

The bank will pay attention to these matters throughout its regular activities, and will include them in its regulations and training sessions given to employees.

## **With respect to transactions performed by third parties and walk-in customers,** the bank will conduct verification and identification procedures, consistently apply the proper KYC rules, and, if necessary, receive corroborating documentation. The bank will include restrictions on cash transactions made by third parties and walk-in customers.

## **When providing services to other banks in foreign countries (correspondent banking services)**, the bank will assess the nature of the business activities of correspondent banks working with it, as well as their efforts to prevent money laundering and terror financing. The bank will not take part in correspondent banking services with any banking institution that is not under AML and CFT supervision, or any banking institution with no physical presence (unless it is connected to a supervised banking group).

## The bank will act in accordance with Israeli law to avoid participating in any business activities with entities included in the sanctions lists published by OFAC, the United Nations and the European Union. In any case, the bank will take steps to ensure it does not violate the sanctions directly or indirectly imposed by those entities. The bank shall take reasonable steps to identify the accounts of the entities that appear in the sanctions lists, and shall handle them in accordance with its risk-based policy.

## The bank will act in accordance with Israeli law to maintain the level of compliance required by FATCA legislation, and, inter alia, shall not open or manage the accounts of non-compliant financial institutions.

## The bank will take steps to mitigate the risk involved in relationships with sanctioned entities in light of the situation in the Ukraine, based on declarations made by the US Department of the Treasury[[1]](#footnote-1). These steps shall include:

### Referring to entities appearing on the various lists as being under a sanction regime.

### No new accounts will be opened at the bank for the entities appearing on the list.

### If possible, the existing accounts of entities appearing in the list will be located and handled according to the risk-based approach.

# The compliance risk management process for AML/CFT includes the following activities:

* **Mapping** sources, activities and processes.
* **Identifying** the major risks.
* **Assessing** the potential damage these risks entail and the likelihood that they will materialize.
* **Monitoring** the risks.
* **Controls and work processes** – determining mechanisms for control and work processes, and the way the said mechanisms are to be implemented by the function responsible for conducting the organizational or business process.
* **Ongoing control** of changes within and outside of the organization pertaining to activities and processes that affect the extent of exposure to AML/CFT compliance risks.

Determining the level of investment required to reduce the risks or the likelihood that those risks will materialize, in accordance with the risk appetite and tolerance.

The bank’s AML/CFT risk appetite and tolerance is zero.

## Mapping AML/CFT compliance risks

Risk mapping will be performed through a process that includes:

* Identifying the sources and activities that generate AML/CFT compliance and exposure risks.
* Identifying and locating material AML/CFT exposure and compliance risks within the bank’s various units and subsidiaries, including those identified by the employees of the AML unit. Findings will be documented in a computer database and classified according to risk, legal issue, business line, lead, and other criteria. Risks and exposures will be prioritized, and a program for mitigating and handling risks will be defined.
* Updating the map of risks and exposures originating in internal and external sources, pursuant to information in the bank’s possession.
* Conducting an annual assessment of the exposure and risk map and determining a work plan, taking into account the budget and priorities, in order to mitigate and handle risks. This work plan will be expressed in the annual assessment report.
* The said risk mapping process shall follow accepted methodologies and definitions for assessing compliance risks, as approved from time to time, in coordination with the chief compliance manager.

## Evaluation of exposures and control mechanisms

### **Reports and inquiries concerning AML/CFT exposure and compliance risks and their documentation**

The process of managing AML/CFT compliance risks requires functions to contact the AML unit and report any bank activity with AML/CFT implications, including customer complaints and lawsuits filed against the bank. As such, a procedure will be set in place, which will obligate the aforementioned functions to contact the AML unit each time an event or activity entailing or suspected of entailing an AML/CFT risk or exposure is encountered, in order to receive professional counseling, manage AML/CFT exposures, and generate lessons learned.

To generate lessons learned and update the AML/CFT risk assessment, the AML unit shall use the system to document significant AML/CFT exposure and compliance risks, including:

* Material AML/CFT compliance risks that have materialized
* AML/CFT compliance risks avoided during activities
* New AML/CFT risks that were identified
* AML/CFT compliances risks (that were avoided or that materialized) in the Israeli banking system or foreign banking systems that were publicized

In cases where we understand that events and developments pertaining to AML and CFT in Israel may substantially affect the bank’s activities, the AML unit will relay the necessary information on these events to the authorized organs at the bank.

### **The assessment of material compliance exposures**pertaining to AML and CFT shall be based on the assessment of damages incurred through the realization of a compliance exposure:

* Assessment of control mechanisms and their efficiency.
* Assessment of the likelihood a compliance exposure will materialize.

The performance of the said assessment of exposures and risks shall be based on the compliance risk assessment methodology contained within the bank’s risk compliance policy paper.

### **Monitoring AML/CFT compliance risks.** Automated monitoring of bank customer activity shall be done through a system that issues alerts based on predefined characteristics and rules, in accordance with their risk factors. Moreover, there will be a system designed to help identify terror organizations and terror operatives trying to make use of terrorist property or other illegal activities at the bank or through the bank.

### **Conducting controls, including ad-hoc (self-initiated) controls,** on the part of either the AML unit or the retail and customer asset division, in order to follow up on how the bank’s customer accounts are handled in terms of AML and CFT.

### **Internal auditing** shall include, in its audit report, instructions for evaluating compliance with legal requirements pertaining to AML and CFT, as part of the bank’s multi-year plan.

# Reporting and documentation procedures

Other than its various reporting and documents obligations, as specified in this policy paper, the bank will run reporting, monitoring and updating processes on material exposures and compliance risks pertaining to AML and CFT, and this material will be sent to the chief risk officer, the bank’s management, and the board of directors, in the following manner:

## **The officer in charge of AML and CFT at the bank** will submit special reports to the bank’s management and board of directors covering material or exceptional issues that require an urgent response from the management or board of directors, including the case of immediate implications for the bank’s operations or a suspicion that the bank’s reputation may be harmed, as the case may be.

## The **AML unit** will submit an annual assessment report to the bank’s management and the Chief Risk Manager, with the following contents:

* A map of material compliance and exposure risks pertaining to AML and CFT
* The materialization of the said risks in the reporting period
* Updates on the emergence of new risks and the handling of existing risks
* Exceptional events

The report’s findings will be delivered to the relevant board committee and to the plenary of the board of directors, and will be discussed.

## **The internal auditor** will regularly submit audit reports pertaining to AML and CFT to the officer in charge of AML and CFT.

## **The bank will act in accordance with the following rules with regard to documentation of records:**

* The bank will store and hold all its customer identification and verification documents, as well as documents pertaining to transactions executed at the bank, and reports that it had submitted to the competent authorities, which may be produced from time to time, for the minimum period of time it commits to, as required by law, with regard to AML and CFT.
* From time to time, the bank will conduct surveys designed to ensure it has adequate and updated information on transactions performed at the bank. More robust surveys will be conduct for high-risk customer accounts. If the bank discovers that significant information on a customer is missing, the bank will take the necessary steps to ensure it obtains the relevant information as soon as possible.

# AML/CFT Training and enforcement of AML/CFT compliance

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The bank will create and implement training and assimilation programs to ensure it complies with legal requirements pertaining to AML/CFT, and is responsible for the following areas:

## Creating training programs to train the employees of the AML unit, and consistently maintaining a high level of professionalism.

## **Passing on knowledge** to the various bank units on changes in the law, and the implications of those changes for the bank’s activities, policies and regulations, support and assistance in developing training programs and teaching professional knowledge, which are designed to ensure ongoing compliance with AML and FCT regulations and the requirements stemming from the bank’s policies, including responsibility to ensure that:

## **new workers,** having gone through onboarding, have read the AML regulation booklet and have taken a test on the subject.

## AML content will be conveyed in the framework of the **annual training program**through dedicated trainings and in the framework of courses and other forums.

## **AML trustee conferences** will be held at a sufficient frequency, and they will be used to convey content and regular updates in this area.

## With regard to **handling compliance violations,** the provisions of the bank’s risk compliance policy paper, as well as regulations that apply to matters coming within the scope of this policy paper, shall apply.

# Subsidiaries

The bank’s AML/CFT compliance risk policy shall be adopted by the bank’s subsidiaries’ authorized organs and shall apply to them, just as it applies to the bank’s other units, and is subject to changes required by the provisions of special laws that apply to them, and by the nature of the activities conducted by each subsidiary.

An AML officer shall operate at the relevant subsidiaries. The officer shall be responsible for generating and updating compliancy risk management policy pertaining to AML and financing within the subsidiaries themselves. Their interfaces with the AML unit will be as follows:

* Reporting to the AML unit on risks pertaining to compliance, exposure, and exceptional activities tied to AML and CFT.
* Contacting the AML unit to receive professional guidance and support for which entail exposure and compliance risks tied to the prohibition of money laundering and terror financing, while coordinating the process of handling the issue.

1. In accordance with a letter issued by the Bank of Israel on April 4, 2015 [↑](#footnote-ref-1)