GUIDANCE NOTE ON AML/CFT RISK BASED APPROACH FOR DEALERS IN JEWELLERIES, PRECIOUS METALS AND STONES

ISSUED BY SPECIAL CONTROL UNIT AGAINST MONEY LAUNDERING 2019

Contents

1. Risk-Based Approach for the Designated Non-Financial Institutions

The Special Control Unit against Money Laundering (SCUML) has commenced implementation of the outcome of the Nigeria National Money Laundering/Terrorist Financing (ML/TF Risk Assessment)(NRA) concluded in 2016. The Assessment was conducted as a response to Recommendation 1 of the Financial Action Task Force 40 Recommendations. The **Recommendation** urges countries to identify, assess and understand their ML/TF risks and apply mitigating measures commensurate to identified risks.

Following the conclusion of the Nigerian National Risk Assessment (NRA) exercise, the country developed a National Strategy from the findings of the NRA as contained in the National AML/CFT strategy 2018-2020.

Accordingly, individual reporting entities or DNFIs are required to conduct an assessment of their own Money Laundering /Terrorist financing risk (ML/TF)in line with the risks identified in the NRA using customers, countries or geographic areas, products and services, transactions or delivery channels.[1]

Such as when on-boarding new customers, and throughout the relationship with each customer, Designated Non financial institutions are required to perform anti-money laundering (AML) and know-your-customer (KYC) risk assessments to determine a customer's overall money laundering risk.

In order to achieve the above objective of combating ML/TF, it is essential to have a clear understanding of the threats/vulnerabilities to the dealers in precious metals and stones in particular and the Designated Non-Financial Institution sector in general. Consequently, SCUML has developed an AML/CFT risk assessment template and information collection tool herewith attached for your guidance.

Please note that SCUML is available to guide your understanding and utilization of the developed template and tool where required.

2. Introduction

In today's emerging risks and challenges, Designated Non Financial Businesses and Professions (DNFBPs) which is referred to as Designated Non- financial institutions (DNFIs) in S.25 of the Money Laundering Prohibition Act, 2011 as amended are seriously exposed to vulnerabilities of money laundering, terrorist financing and proliferation of weapons of mass destruction and consequently risk being sanctioned. It is therefore necessary to adopt preventive measures that will ensure effective application of mitigation measures .According to the Financial Action Task Force (FATF) guidance on FATF Report: Money Laundering and Terrorist Financing through trade in Diamond October 2013.

Risk Based Approach (RBA)"Risk Based Approach in AML/CFT means the identification, Understanding and Assessment of ML/TF risks to which they are exposed and take AML/CFT measures commensurate to those risks in order to mitigate them effectively. This approach should be an essential foundation to efficient allocation of resources across the anti-money laundering and combating the financing of terrorism (AML/CFT) regime and the implementation of risk based measures throughout the FATF Recommendations.

Based on the foregoing, Nigeria conducted her maiden National Risk Assessment (NRA) on Money Laundering/Terrorist Financing in 2016, the assessment covered the period between 2010- June 2016. The report findings revealed that the risk posed by Jewellery dealership is medium-high in Nigeria.[2]In line with Regulation 10(7) of Federal Ministry of Industry, Trade and Investment (Designation of Non-Financial Institutions and Other Related Matters) Regulations, 2013, it is required that DNFIs conduct their risk assessment and come up with measures to mitigate the risks thereof.

For the purpose of guidance, find below a risk based approach manual to guide the operations of the sector.

2.1 Purpose and objective

- Inculcate awareness and understanding of what the risk-based approach involves.
- Outline the high-level principles involved in applying the risk-based approach.
- Indicate good practice in the design and implementation of an effective risk-based approach.

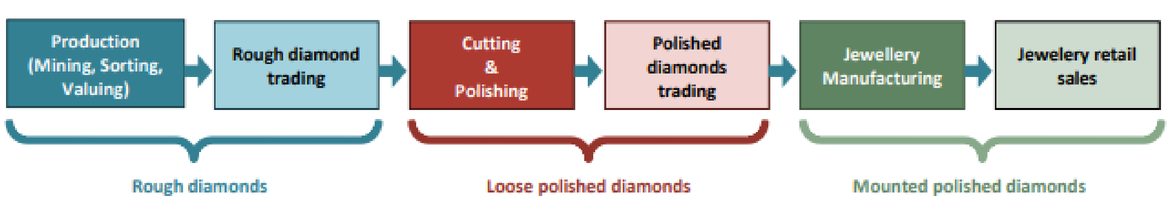
2.2 Target audience

- Dealers in precious metals and stones which include persons
    - Who produce precious metals or precious stones at mining operations,
    - Intermediate buyers and brokers,
    - Precious stone cutters and polishers and precious metal refiners, To Jewellery manufacturers who use precious metals and precious stones,
    - Retail sellers and to the public,
    - Buyers and sellers in the secondary and scrap markets.
    - SRO/Association of dealers

2.3 Precious Metals, Stones and Jewelleries pipe-line diagram

The diagram below describes the stages involved in production and processing of diamonds up to the retail consumer which involves variety of transactions.[3]

Figure 1: **Diamond pipeline diagram**



Note: This only represents this licit diamond trade.

2.4 Understanding of the activities of dealers in jewelleries, precious metals and stones sector

Diamonds have the ability to earn, move and store value. They are a liquid and transferable asset. These are some of the features that make diamonds appealing to criminals seeking to move, conceal and store the proceeds of crime. Diamonds have unique physical and commercial properties which carry value in small, easily transportable quantities. The worldwide trade varies from modern international transactions conducted through the financial system, to localized informal markets. Dealers range from very poor individuals in some of the most remote and troubled places on the planet, to the wealthiest individuals, to large multinational companies working in major financial centre. Transaction methods also range from anonymous exchanges of handfuls of stones or nuggets for cash, to exchange-based government-regulated deals. [4]

2.4.1 Vulnerability of precious metals and stones

The following are the factors that make the sector vulnerable to ML/TF

- **Very high value** – diamonds can store very high value. The higher the value, the more vulnerable a commodity is to ML/TF.
- **Low weight/mass and relatively small size** – high value to mass ratio (easy to transport/smuggle) – diamonds are easy to move and conceal, which makes them susceptible to smuggling.
- **High durability with stable pricing** and an ability to retain value over long periods of time – this makes them good for investment purposes (origin of money may be outside the industry). Also, it may attract criminals as they can distance the funds from their origin by transferring proceeds of crime into diamonds with minimum risk of confiscation and low risk of loss of value.
- **Ability to go undetected (non-metallic and odourless)** – diamonds will show on x-ray but because of the low density to x-rays they remain 'difficult' to detect.

- **Untraceable** - once the items change hands and enter the market they are difficult to trace, in terms of both their original ownership and value.
- **Easily bought and sold outside the formal banking system** – AML/CFT measures are higher in the formal banking systems, but diamond transactions can be conducted outside this system and the value is carried between countries without having to go through the KYC procedures in the banking sector. Also, diamonds can be bought and sold in all parts of the world at almost any jewellery or pawn shop.
- **Unmarked** - It is virtually impossible to distinguish between rough diamonds that were illegally obtained and those that were legally obtained. Technology allows for the marking of diamonds so it would be possible to follow the trail of the diamonds, i.e. who is involved in the sale/purchase of the diamonds, however, most diamonds are unmarked.

  One of the key changes in the regulation of diamonds is the implementation of the Kimberley Process Certification Scheme (KPCS) for rough diamonds.

  The Kimberley Process (KP) is a voluntary export/import control regime, supported by the United Nations, and focused on stopping the illicit trade in rough diamonds to finance armed conflict (i.e., the use of rough diamonds as an alternate currency used mainly to buy weapons). It is not an international legally enforceable agreement, and its compliance flows from the national implementation legislation in participating countries. From an AML/CFT perspective what is important to note here is that the KPCS does not deal with ML or with TF activities and is limited to rough diamonds only. Thus polished diamonds are not covered by the KPCS as it is believed that all polished diamonds come from KP certificated rough diamonds.

3.0 Understanding of the RBA

Risk is defined as the possibility of some adverse event occurring and the likely consequences of this event. Risk is expressed as;

- combination of **threat** and **vulnerabilities**

- Risk is also defined as Risk = Likelihood x Consequence

ML threat refers to

The proceeds of crimes in a country which includes

- The proceeds generated in the country (internal threat)
- The proceeds that come from other countries (external threat)

ML Threat Assessment should analyze

- The frequency of predicate crimes that generate illicit proceeds
- The scale of illicit proceeds in the country
- The scale of ML in the country
- ML methods and trends in the country

TF threat

- Refers to the scale of funds raised/ moved/used or utilized/transiting to support TF activities and groups

Vulnerability

- Is the state of being exposed to weaknesses and gaps in defense mechanisms against ML/TF, which can be at the national and/or sector level.

A vulnerability assessment should analyze the following:

- Lack of awareness, commitment, knowledge, resources
- Weaknesses/gaps in AML/CFT laws and regulations
- Weaknesses/gaps within Designated Non-Institution and Financial Institutions frameworks (FIU, police, judicial, etc.)
- Weaknesses in infrastructures (ID infrastructure, STR collection and analysis)
- Economic, geographical, or social environment factors
- Low awareness and general or specific control mechanisms:

3.1 Components of the risk-based approach and risk profiling

Designated Non Financial Institutions are required to take appropriate steps to identify, assess, understand and mitigate their ML/TF. The assessment should be documented. **FATF Recommendation 1** is considered the groundwork towards the implementation of the risk-based approach: See figure 1 below:

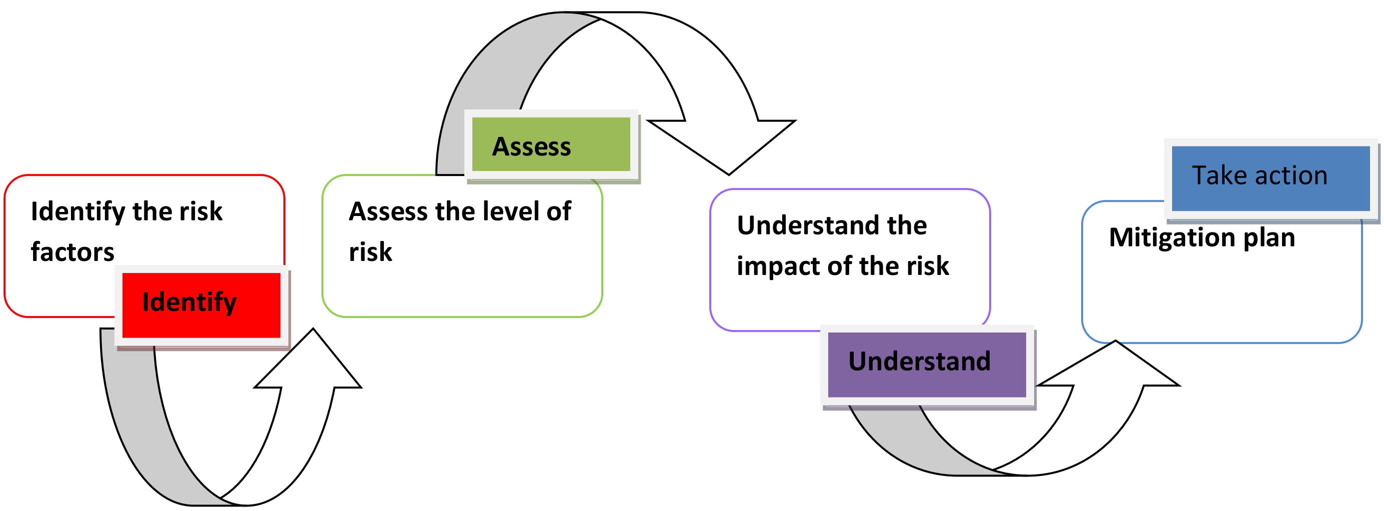


Figure 1: Risk based approach implementation Groundwork[5]

3.2 Risk Factors

Accordingly, the main components that drive a risk assessment by the Designated Non financial institution are as recommended by the Wolfsberg risk-based approach guidance has provided an insight on the approach by identifying these components that can assist in measuring the risk[6].

"Money laundering risks may be measured using various categories, which may be modified by risk variables. The most commonly used risk criteria are as follows:

- **Country/Geograpical risk**
- **Customer risk**
- **Product and Services risk**
- **Industry risk**

See figure 2 below for details:

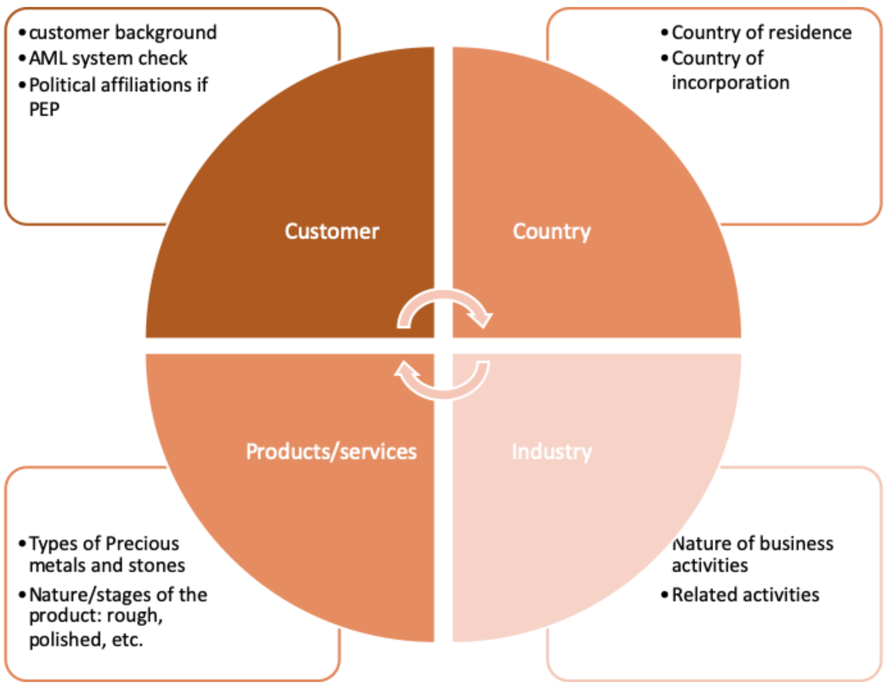


Figure 2: Risk Based Approach: Risk Factors

3.3 Risk Factors For The Precious Metals and Stones Sector

The risk factors have been modified as seen below for the precious metals and stones sector for the purpose of conducting a risk based assessment in the sector. The list is non exhaustive.

Customer Risk

- Student
- Minor

- House Wife
- Politicians(PEP)
- Civil Servant
- Business Person(type of business)
- Foreigner/Resident
- Unknown beneficial owner
- Offshore companies
- Lawyers, TCSPs
- NGOs

Geography/Country Risk

- Location of Property
  State
  Central Business District
  High brow
  Middle brow
  Low brow
- Crime Prone Areas
- State/Town/Country of buyer
- Safe haven location for Terrorism
- Safe haven location for Tax evasion
- Border Towns

Industry/Sector Risk

- Global nature of the trade
- Use of jewellery as currency
- High value

Product/Service Risk

The under listed are typical characteristics of Product/services for dealers in precious stones and metals sector:

- Rough
- Polish
- Finished Jewelry

3.4 Modified risk Variables

It is important to identify the risk factors which will assist in defining the weightage or classification of the customer (weighted risk level) by listing each component and attributing a **rating** or **score** that will allow the risk rating.

3.4.1 Customer Risk

In order to define the customer risk, the Designated Non-financial institution should understand the nature of the **customer** that should be rated based on its vulnerability (the DNFI's) in relation to the Customer's threat to money laundering and terrorist financing (e.g., the AML/CTF risk would be higher for a PEP customer than for a civil servant). it is therefore necessary that a thorough understanding of all the risks associated with the customers should be obtained prior providing a risk rate.

3.4.2 Country Risk

High-risk countries to ML/TF have been identified by many regulatory and advisory bodies such as the Financial Action Task Force **(FATF), World Bank, Transparency** International, **United Nations,** Office of Foreign Asset Control (**OFAC)** etc based on certain characteristics as stated below which can assist in understanding the level of risk such as the level of stability and corruption, terrorist and criminal activity.

- Countries not having adequate AML/CTF systems
- Countries subject to sanctions, embargoes issued by the U.N., EU and OFAC
- Countries having significant levels of corruption or other criminal activities such as narcotics, arm dealing, human trafficking, illicit diamond trading, etc.
- Countries identified to support terrorist activities, or have designated terrorist organizations operating within their country.

3.4.3 Product /Services Risk

The risk level of products and services should be identified based on their vulnerability to money laundering and terrorist financing. Precious metals and stones industry has always functioned on the basis of trust.

- **Very High value,** Diamonds can store very high value, the higher the value the more vulnerable a commodity is to ML/TF.

- **Low weight/mass and relatively small size – high value to mass ratio (easy to transport/smuggle)** – diamonds are easy to move and conceal, which makes them susceptible to smuggling. The transfer of value between countries is in many cases part of ML/TF schemes and diamonds allow for the transfer of very high value.

- **Ability to go undetected (non-metallic and odourless)** – diamonds will show on x-ray but because of the low density to x-rays they remain "difficult" to detect and can be easily transported and thus makes it easy for terrorist to move high valued goods to finance terrorism..

The product could be transported undetected due to low density to x-rays, and it is non-metalic and odourless, thus makes it easy for terrorist to move high-valued good to finance terrorism.

Evaluation of Price: The subjectivity of the valuation of diamonds is a significant vulnerability. There are no official or agreed tariffs for rough or polished stones. The per-carat price of a diamond can vary considerably based on the crystalline shape, the carat weight, the colour and the clarity, i.e. the four (4) C's. Each qualifier imparts an individual measure of a diamond while also affecting the valuation of the other qualifiers; each measure is subjective and cannot be precisely stated (except carat weight).

3.4.4 Industry

The industry refers to the nature of business activities and related activities which typically involves production ,mining,sorting,trading of rough diamonds, cutting and polishing as well as jewellery manufacturing and jewellery retail sales.

3.5 Risk Scoring

After the identification of the risk variables, the next stage is to develop a risk assessment by calculating the risk, based on the level of impact and threat considering the weightage and risk scoring in order to classify the risk properly.

Attributing the risk rating should be in a numerical format. The DNFI can choose ranges from 1 to 5 with 1 being the lowest and 5 being the highest

100%	80%	60%	40%	20%
5	**4**	**3**	**2**	**1**
Very High	High	Medium	Medium Low	Low

Risk Scoring	5	4	3	2	1
Risk Level	Very High	High	Medium	Medium Low	Low
Due Diligence Level	EDD		Simplified due diligence	CDD	
Approval	AML Committee	CCO	HOD	Relationship Manager/Staff	

The first step in implementing RBA is identifying the risk factors and setting up risk scoring. The process can be simple or sophisticated depending on the size, nature of business and its complexity. The method should allow the integration of RBA with the Designated Non financial institution's customer on-boarding process.

Dealers in precious metals and stones should embark on risk assessments of their business and developing appropriate risk mitigation policies.

4. Suspicious Transaction Reporting

- The reporting of suspicious transactions or activity is critical to a country's ability to utilize financial information to combat Money Laundering and Terrorist Financing. The Money Laundering Prohibition Act 2011 as amended and other legislation requires Designated Non Financial Institutions to file suspicious transaction reports when the need arises. See list of relevant sections of legislation:

- Section 6(2)of the ML(P)A2011 as amended —
- Section 14(1) of the Terrorism (Prevention) Act 2011
- Section 8(a) of the Terrorism (Prevention)(Amendment)Act 2013
- Regulation 8(1) of the Terrorism Prevention (Freezing of International Terrorists Funds and Other Related Measures) Regulations 2013
- Reg. 22 of the (FMITI) Federal Ministry of Industry Trade and Investment, AML/CFTRegulations2013 SCUML

- Where a legal or regulatory requirement mandates the reporting of suspicious activity as enshrined in the various legislation:

    - Section 6(2)of the ML(P)A2011 as amended
    - Section 14(1) of the Terrorism (Prevention) Act 2011
    - Section 8(a) of the Terrorism (Prevention)(Amendment)Act 2013
    - Regulation 8(1) of the Terrorism Prevention (Freezing of International Terrorists Funds and Other Related Measures)Regulations 2013
    - Reg. 22 of the (FMITI) Federal Ministry of Industry Trade and Investment, AML/CFTRegulations2013,SCUML

- Designated Non Financial Institutions are required when once a suspicion has been formed, to file a report and therefore, a risk-based approach for the reporting of suspicious activity under these circumstances is not applicable. All these instruments mandate reporting entities to file STRs to the NFIU via info@nfiu.gov.ng.

- A risk-based approach is however, required for the purpose of identifying suspicious activity, for example, by directing additional resources at those areas a dealer has identified as higher risk. As part of a risk-based approach, it is likely that a dealer in jewelleries, precious metals and stones will utilize information provided by designated competent authorities or SROs to inform its approach for identifying suspicious activity. A Dealer should also periodically assess the adequacy of its system for identifying and reporting suspicious transactions.

5. Internal Control Systems

Many DNFIs differ significantly from financial institutions in terms of size. By contrast to most financial institutions, a significant number of DNFIs have only a few staff. This limits the resources that small businesses and professions can dedicate to the fight against Money Laundering and Terrorist Financing. This peculiarity of DNFIs, including Dealers in precious metals and stones, should be taken into account in designing a risk-based framework for internal control systems. Application of know your customer measures, customer due diligence procedures, reporting(CTR) and compliance obligation/processes by DNFIs.

In order for Dealers to have effective risk-based approaches, the risk-based process must be imbedded within the internal controls of the firms. The success of internal policies and procedures will be dependent largely on internal control systems. The two key systems identified are as follows;

1) Culture of compliance amongst all
2) Senior management ownership

1. Culture of compliance amongst all

This should encompass:

- Developing, delivering and maintaining a training program for all designated agents and employees.
- Monitoring of any government regulatory changes.
- Undertaking a regularly scheduled review of applicable compliance policies and procedures within the dealer firms will help constitute a culture of compliance in the industry.

2. Senior management ownership

Strong senior management leadership and engagement in AML/CFT is an important aspect of the application of internal control measures. Senior management must create a culture of compliance, ensuring that staff adheres to the Jewellery firm's policies, procedures and processes designed to limit and control risks. Within precious metals and stones agencies, the front line of the transaction is with the individual dealer.

Therefore, policies and procedures are effective only at the point that firm/company owners and senior management support the guidance.
Having regard to the size of the precious metals and stones/jewellery's firm, the framework of internal control should:

- Provide increased focus on dealers' operations (products, services, customers and geographic locations) that are more vulnerable to abuse by Money Launderers and other criminals.
- Provide for regular review of the risk assessment and management processes, taking into account the environment within which the dealers operates and the activity in its market place.
- Designate an individual or individuals at management level responsible for managing AML/CFT compliance.
- Provide for an AML/CFT compliance function and review programme.
- Inform senior management of compliance initiatives, identified compliance deficiencies, corrective action taken and suspicious activity reports filed.
- Implement risk-based customer due diligence policies, procedures and policies.
- Provide for appropriate training to be given to all relevant staff.

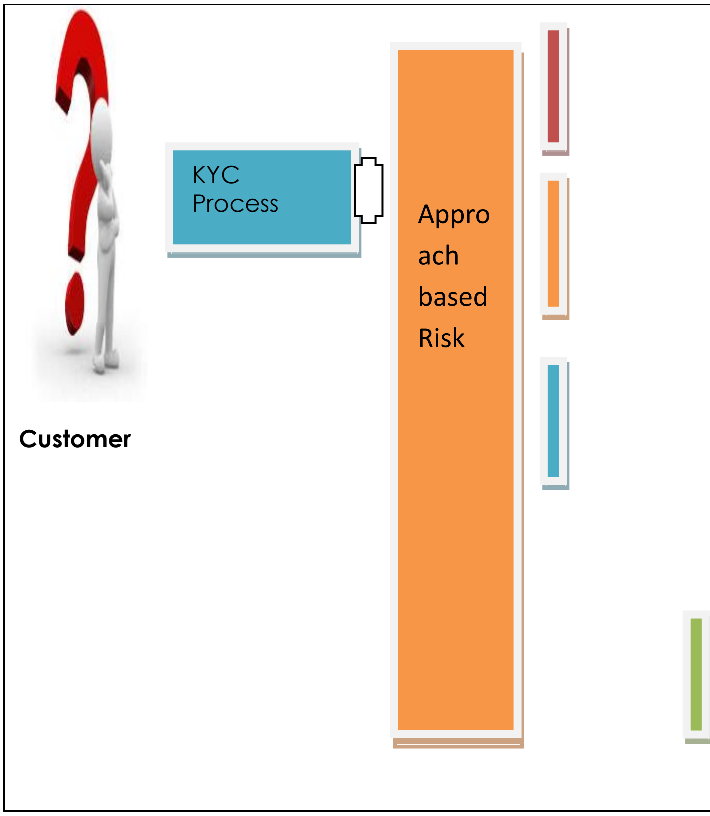
ANNEXURES: Annexure 1

Customer Risk Assessment

Date	9/8/2018	Department	Private Sector Sales
Customer introduced by	Agent/dealer	Account Manager	
Customer Name	Abubakar Emeka Yemi		

Risk Factors	Risk Description	Rating Range	Description	Risk Rating
Customer type Public Sector Private Sector Business man	**Nature of the customer** • Ex. Governor • Student • Civil Servant	**1-5(5-Highest,1 lowest)**		• 5
Countryof incorporation/ Nationality	Foreigner(BVI,Iraq)			• 5
UBO	Ultimate beneficial owner		Company in BVI	• 5
Products & Services Type	• High volume of precious metals, stones and jewelleries		Use of cash for payment Use of trust.	• 5

Annexure 2: Customer on boarding lifecycle

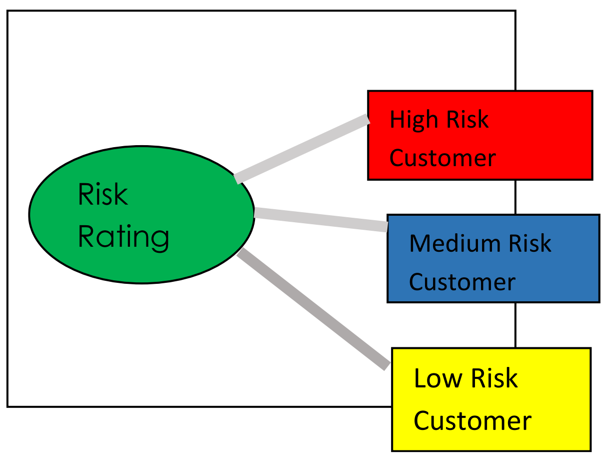


Customer
Type of Customer and Watch List screening(PEP, Natural or Legal Person)

Country
Country of residence and origin and risk factors of the country(sanctioned, highly corrupt, high risk)

Industry
Nature of business that the customer is involved the risk level

Product and Services
Type of services (sale of rough gold or diamond, polished or finished jewellery, multiple sale etc)



[1] FATF Recommendation 2012-Interpretatiove Note to Recommendation 1

[2] National Risk Assessment of Money Laundering and Terrorist Financing in Nigeria 2016.

[3] FATF Report: Money Laundering and Terrorist Financing through trade in Diamond October 2013.

[4] FATF Report: Money Laundering and Terrorist Financing through trade in Diamond October 2013.

[5] FATF Recommendations, Recommendation No.1, 2012.

[6] Wolfsberg Statement, Guidance on a Risk Based Approach for Managing Money Laundering Risks, 2006.

[7] Typologies of Money Laundering through the Real Estate Sector in West Africa, 2008