

MAJOR ENHANCEMENTS IN AML/CTF COMPLIANCE  
AND OTHER RELEVANT DEVELOPMENTS

# Citadele bank



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## **=** **Citadele**

### **PROFILE OF THE BANK**

#### **Brief description of the bank**

Citadele bank aims to become the primary bank of choice for aspiring retail and small business customers across the Baltics, and to continue to improve products and services for clients in the corporate and private capital management segments. Citadele supports sustainable growth of local small and medium size enterprises, whilst contributing to stability and prosperity of Baltic economy. The core market of Citadele and Citadele Group is the Baltic states: Latvia, Lithuania and Estonia.

Citadele Group head quarter is located in Latvia, and its subsidiaries and branches operate in Latvia, Lithuania, Estonia and Switzerland.

Citadele's shareholders are an international group of investors with global experience in the banking sector. 75% plus one share belongs to a consortium of investors led by Ripplewood Advisors LLC and co-investors; 25% minus one share belong to the European Bank for Reconstruction and Development (EBRD).

### **Credit rating**

On 19 April 2017, International rating agency “Moody’s Investors Service” has upgraded Citadele Bank’s long-term deposit rating from B1 to Ba2, with positive outlook.

### **Major business lines**

Citadele bank aims to become the primary bank of choice for aspiring retail and small business customers across the Baltics, and to continue to improve products and services for clients in the corporate and private capital management segments.

### **Turnover (% of total turnover) with the companies classified as shell companies**

Citadele is continuing to reduce the turnover proportion of shell companies. The credit turnover proportion of companies that can be classified as shell companies in client’s total credit turnover in 2017 reduced by 5% in comparison with 2016.

### **Structure and profile of shareholders**

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### **RESHAPING OF THE BUSINESS MODEL IF AML/CTF COMPLIANCE DETERMINED (noteworthy, visible and impactful)**

#### **Dependence on the transaction (payment) business and changes therein**

In comparison with 2016, the payment business reduction within the framework of payments made by high risk clients or in payments to high risk jurisdictions in 2017 was reduced by 25%.

#### **Business lines diversification / business lines, which the Bank plans to develop within the revised business model**

Citadele bank pursues the aim to become the primary choice bank for private individuals and SMEs in the Baltics which is the initially defined business model not planned to be changed.

#### **Decrease in turnover (changes) in transactions with shell companies**

Credit turnover of the legal entities meeting the definition of a shell company within the meaning of Regulations of the FCMC No. 234 in the first half-year of 2017 was reduced by 3% in comparison with that at the end of 2016.

**Activities related to elimination of deficiencies according to requirements set forth by FCMC, if such requirements have been applied (for example, upon entering into administrative agreements, FCMC letters, decisions)**

In the first half-year of 2017, the Compliance function was detached to strengthen the AML/CTF field as well as the designated Management Board member was appointed. In the reporting period, there were no other instructions (administrative contracts, resolutions, etc) on the part of the FCMC.

**Forecasts, calculations, which attest the Bank's chosen business model's sustainability in the next 3 years if the turnover decreases significantly, for example, refusing services to shell companies**

Citadele bank's strategic direction to strengthen the position of the Bank in the Baltic states by rendering services to private individuals and SMEs gives confidence about the sustainability of the Bank's business model also in the event if services would not be rendered to the risky clients of the specific segment (for instance, shell companies). Calculations done by Citadele within the framework of the annual risk stress tests and conclusions arrived at on grounds of their results prove that adequate recovery options maintaining liquidity are available to the Bank as well as the calculation results testify that changes will be made in the liquid asset structure in the event of

reduction in the amount of the client's deposits. At the same time, adequate liquidity will be maintained within the limits of the Bank's liquidity ratio individually determined by the FCMC, and the bank does not have to take additional measures; it was also concluded that the Bank is able to continue operating at a profit, and the impact on the capital is assessed as immaterial.

## **CORPORATE GOVERNANCE**

### **Development of new policies and procedures**

In 2016, the ML/TF risk management strategy was developed and approved in compliance with the binding regulations of the FCMC. Other policies and procedures regulating the ML/TF and Sanctions compliance area are valid from when Citadele bank was founded and they are reviewed and updated on a regular basis.

In the first half-year of 2017, Citadele bank developed a technique for the assessment of the Sanctions compliance risks thus supplementing and reinforcing self-assessment of the ML/TF and sanctions risks.

### **Policy for compliance with the UN, EU, national financial sanctions**

A separate Sanctions compliance policy was approved in 2015. It aims to ensure that the Group complies with

the requirements of the sanctions imposed by the international organisations and the requirements of the regulatory enactments of the respective jurisdictions with regard to the imposition of international sanctions in the activity of financial institutions as well as to ensure general AML compliance.

In its activity, the Bank employs sanctions specified by the UN Security Council, European Union, Organisation for Security and Co-operation in Europe, OFAC (USA) and the national sanctions specified by the Cabinet of Ministers of the Republic of Latvia.

Under the Sanctions compliance policy, the Bank, in the rendering financial services to and cooperating with its counterparties, does not get involved in any activities the aim or consequences of which are non-compliance with Sanctions. Citadele bank assesses the risks associated with cooperation with the persons on whom Sanctions have been imposed and does not allow risk tolerance in relation to deliberate non-compliance with the Sanctions imposition requirements and/or shortcomings. Citadele bank does not render financial services specified in the respective Sanctions to the persons on whom Sanctions have been imposed as well as ensures that such persons are denied access to financial funds and financial instruments, and freezes financial funds and financial instruments owned by such persons. Citadele bank does

not perform any civil transactions whatsoever with any economic or financial resources or funds or their parts that are owned, possessed or held by the state or state-related persons or over which such persons exercise effective control if civil restrictions were implemented in relation to said state by virtue of the respective regulatory enactments. Citadele bank ensures compliance with the applicable Sanctions also outside the Republic of Latvia where the bank renders financial services or makes transactions.

### **Increased transparency**

Transparency of the activity is ensured in accordance with the current requirements of legislation and international (for instance, FATF) regulations.

### **Strengthened management and/or supervisory function**

In 2016, five staff members joined the routine staff of Citadele bank's structural unit directly responsible for compliance with the AML/CTF requirements. At the end of 2016, all in all 58 members of staff (37 members of staff at Citadele bank and 15 – in group companies) were performing the AML/CTF, Sanctions compliance and compliance functions.

In 2016, the procedures for formalisation and determination of the detailed reporting guidelines were additionally enhanced.

### **Designated Sanctions officer (function)**

On 01 September 2016, Citadele bank appointed a member of staff responsible for sanctions compliance (Sanctions Officer) as well as strengthened the Bank's Sanctions compliance policies and procedures highlighting the financial sanctions compliance function. Compliance with the requirements of the international and national sanctions at Citadele bank is in force and said requirements have been complied with from when the Bank was founded.

## **INTERNAL CONTROLS**

### **Structural changes**

To strengthen Citadele bank's corporate management, on 29 June 2017 the Shareholders General Meeting approved changes in the Bank's Articles of Association providing for the increase in the number of the Management Board members from five to eight, including providing that the existing composition of the Management Board is supplemented by one Management Board member directly responsible for the compliance matters, including AML/CTF.

In addition, capacity of the internal control system function in the AML/CTF field was also enhanced by increasing the number of members of staff directly involved in the maintenance of the function by five members of staff.

### **Changes in KYC/CDD/EDD/PEP/Financial Sanctions monitoring**

In 2016, the essential changes were as follows:

a) identification and due diligence of the local (Latvian) PEPs and their family members and closely related persons, including approval of the establishment and/or continuation of business relations at the level of the Management Board member responsible for AML/CTF after the enhanced due diligence if the ML/TF risk level acceptable by the Bank is characteristic of the business relations with such a person.

b) monitoring of OFAC's (USA) sanctions performed to verify international transactions was supplemented and employed in the monitoring of the local (within Latvia) SEPA transactions.

### **Changes in on-boarding policies and procedures, including, on-boarding via agents**

In terms of Citadele bank's activity, cooperation with agents (third parties) has never been an essential part of the activity model; therefore, until now agents have attracted only a small number of clients, including no performance of the Bank's processes has ever been delegated to agents.

Since its foundation, Citadele has never performed any active activities related to the jurisdictions outside the Baltic states which traditionally is associated with agent services.

## **TRAINING OF THE STAFF**

### **Training course carried out in the field of AML/CTF in 2016 and 1st half of 2017**

Centralised AML/CTF staff training has been done in Citadele banka since its foundation. The training programme provides for the initial training of new staff members, regular trainings and extraordinary trainings (if such are required). In 2015, the Bank's training programme was intensified by virtue of developing several trends of training programmes to ensure the training content most appropriate for the staff members' line of activity and client segment. Respectively, the training programme envisages differentiated content in the basic programme, private individual, company and private capital management programmes. In the first half-year of 2017, all staff members of the Bank underwent AML/CTF training, including on the Sanctions compliance issues.

In addition to the training organised by the Bank, additional specific trainings were ensured for the AML/CTF function officers and senior management officers.

## **External/internal training**

In 4th quarter 2016 external third party (PwC U.S. office) performed a separate AML training for the bank's management. In addition, another external consultant (Deloitte) carried out AML training for the bank's AML employees.

## **Employee testing and certification results**

According to training program principles all new employees of the Bank must attend initial AML training and to regularly participate in regular trainings in AML area, including training section on Sanctions compliance.

The following certification results of employees involved in AML (incl. Sanctions) compliance are achieved in H1, 2017:

- ACAMS certification – one employee (acquired CAMS)
- ICA certification in Sanctions Compliance area - one employee (acquired ICA Specialist Certificate)
- ICA Advanced Certificate in AML - three employees (certification in process)
- At least once a year a training organized by BDA or SIA Compliance Baltic is planned and ensured for each employee of structural unit responsible for managing AML (Sanctions) compliance;

- All employees of structural unit responsible for managing AML (Sanctions) compliance are granted to participate in specific trainings, workshop, conference to enhance knowledge and skills necessary for their tasks execution.

## **INDEPENDENT TESTING**

### **Consultants independent testing outcome**

Independent auditing to assess compliance of Citadele bank's activity with the USA standards in the AML/CTF field was performed in April 2016. In the findings of the auditors' opinion it is specified that the AML/CTF structural unit and strategic AML/CTF policies and procedures are well organised in the Bank as well as it is pointed out that the Bank implements a series of the most essential control elements, including the comprehensive ML/TF risk assessment and quality control function; a number of shortcomings were identified in the Bank's internal AML/CTF regulating processes and regulatory documents. In the long run, in the auditors' opinion, the Bank's internal AML/CTF control system was assessed as medium; the auditors' opinion gives 15 recommendations and 36 proposals. On grounds of the recommendations given, the Bank developed a plan for the elimination of the shortcomings identified.

### **Level of implementation of independent testing recommended elements**

The plan for implementation of the recommendations and proposals given as a result of the independent inspection was divided into four main implementation time phases. The level of implementation of the recommendations and proposals is very high; as of the end of the first half-year of 2017 only one term of the recommendations implementation plan was delayed; at the same time, regardless of the delay, implementation of the respective recommendation was started under the plan and fulfilled to all intents and purposes. The total plan implementation volume at present is approx. 95%.

### **Further plans for validation of implementation of remediation plans**

Every year Citadele bank makes a plan for the enhancement of the AML/CTF processes which is regularly supplemented in accordance with the changes in the binding regulatory enactments, recommendations of the internal and external audit as well as the Bank's self-assessment of the AML/CTF and Sanctions risks.

### **Internal audit function ability to carry on independent testing in the field of AML/CTF**

The Internal Audit Department is provided with the resources required to carry out independent inspections in the ML/TF field, including the opportunity given to the



members of staff of the Internal Audit Department to raise their competence in the AML/CTF field.

### **Other external audits, outcomes**

In the first half-year of 2017, other external inspections (or audits) in the AML/CTF field (including Sanctions compliance) were not carried out at Citadele bank.

Citadele plans to start the repeated AML/CTF inspection at the end of 2017 and involve the company which had carried out the previous inspection or choose any of the Big Four auditing companies.

## **AUTOMATED SYSTEMS AND TOOLS**

### **Concise description of IT systems, changes (upgrades) in 2016 - H1 2017**

Citadele has not made significant or major changes in deployed IT systems in 2016 and H1, 2017. Citadele on a regular base improves its IT systems functionalities as well as automates and enhances AML process based on existing IT resources, for example, implementation of automated customer's individual AML risk scoring model in core system.

### **Core banking system: name / supplier:**

T24, vendor: Temenos

### **AML/CTF monitoring system: name / supplier**

AML Manager (previously "Erase"), vendor: Fiserv

### **Sanctions screening system: name / supplier / online 24/7 or T+1/2/3**

System "Compliance Link", data base - World Compliance/provider Reed Business Information (Accuity)/online 24/7

### **Other IT solutions, databasis**

"Spark" data base, provider – Interfax. State public registers (for example, Land register) State Revenue Service data base

### **Closed gaps, improved effectiveness, particularly in management of international financial sanctions**

In 2016 Citadele implemented automated sanctions list update mechanism (every hour 24/7/365), manual update as an option in case of emergency. Screened payments: all currencies; in/out SWIFT, in/out cross border SEPA, domestic (local) SEPA payments.

## **DE-RISKING OF CUSTOMERS AND BUSINESS LINES**

### **Business lines exited**

As it was mentioned above, since its foundation the Bank has not developed high risk lines of business, whereas in relation to the existing business lines it has enhanced the mechanisms of monitoring.

### **De-risked customers**

In accordance with the FCMC's regulations on the enhanced client due diligence for the payment and electronic money institutions, the Bank has changed the AML/CTF risk assessment algorithms. In general, the number of high risk clients in the specified period has decreased considerably.

### **Changes in number of PEP customers**

The increase in the number of PEP clients is associated with the changes in the national legislation. In terms of cooperation with foreign PEPs, Citadele bank maintains a rather reserved attitude and cautiously commences cooperation with new clients who meet the status of a foreign PEP (including their family members and persons closely related to PEPs).

Following changes in laws, the number of PEP clients in the first half-year of 2017 increased up to 1,367 clients, whereas at the end of 2016 their number was 741, and

at the end of 2015 – 264 (The number of clients also includes legal entities if their UBO or the controlling person meets the PEP status).

### **Target markets**

Citadele bank's target markets are the Baltic states: private individuals and SMEs sector of Latvia, Lithuania and Estonia.