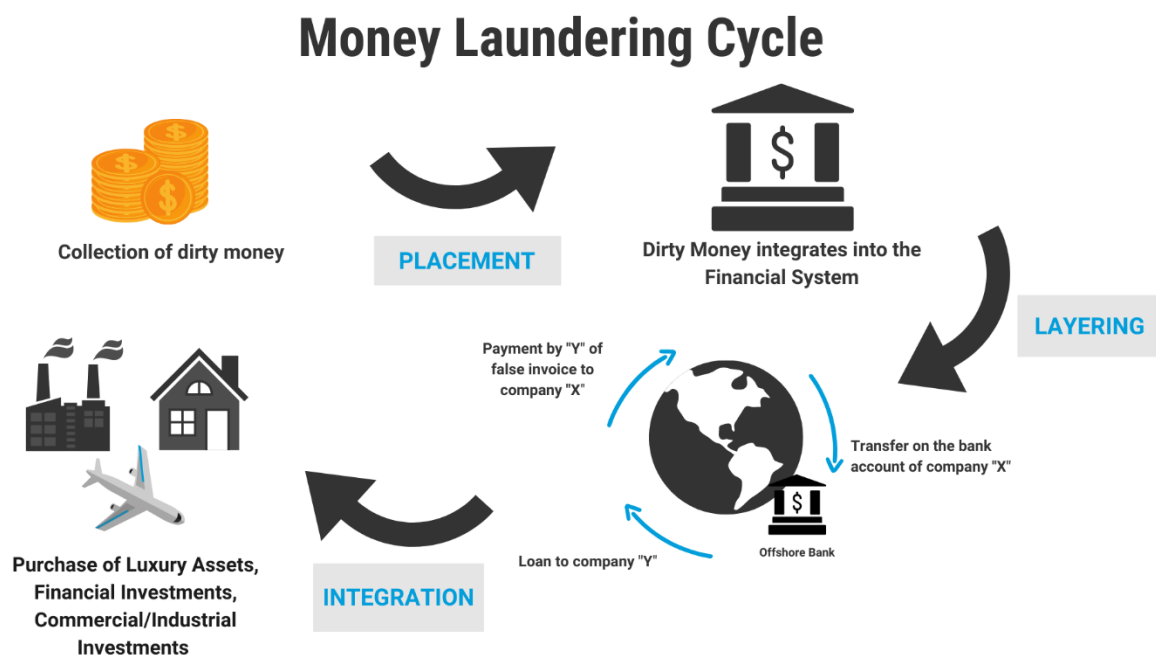


## Source of Funds VS Source of Wealth

Source of Funds and Source of Wealth - do these terms hold the same meaning? Many tend to get confused. The answer is that they are different in scope, yet they are based on the same principle - money. According to S. Karimzadi and his book "Money and its Origins", money started out with what we call bartering, or better, the act of trading one good for another. Bartering was, but still is today, a primitive way of exchanging goods without making use of money. Hence, a bartering economy and a monetary economy differentiate on several levels. Focusing onto a money-driven environment, the payments world keeps on evolving as we speak, and the more it grows, the more laws and regulations are introduced to implement proper, rightful, and lawful ways to utilize money. Why? Because as much as money has paved the way for multiple opportunities, such as the ability to purchase and invest for greater returns, it has also brought upon its repercussions-bringing to the fore aspects revolving around Money laundering and Financing of Terrorism.



Power has been maximised through the advancement of technology and with that, so have its risks, such as new and effective ways of money laundering. Money launderers are constantly trying to find illegal ways to introduce “dirty money” in “clean” ways wherein the money then can be freely used in legitimate business operations. The process of money laundering can be explained as having three stages, namely the **placement** stage, the **layering**, and the **integration** stage. The United Nations Office on Drugs and Crime (“UNODC”) describes the **placement stage** as “the initial entry of the proceeds of crime into the financial system” (United Nations Office on Drugs and Crime, April 2018). The UNODC proceeds to explain that this stage serves two purposes, “it relieves the criminal of holding large amounts of cash obtained illegally and it inserts the money into the legitimate financial system” (United Nations Office on Drugs and Crime, April 2018). The **layering** stage refers to these funds being moved around to separate them from its source, mostly internationally. This process may also be referred to as “structuring” and is certainly the most complex stage of the three. The third and final stage, termed the **integration** stage, refers to the re-integration of the funds through legitimate sources, to be finally returned to its owners as “clean money”.



Once these funds are made available and usable once again, its owners may decide to dispense of them in various ways, such as by purchasing properties and incorporating companies. Hence, the global fight for the Prevention of Money Laundering and the Funding of Terrorism (PMLFTR) is fundamental in order to limit the circulation of illicitly earned funds as much as possible. As subject persons (i.e. persons – including organisations – such as accountants, auditors, legal professionals, notaries and other service providers - who are subject to the PMLFTR [Prevention of Money Laundering and Funding of Terrorism Regulations] and hence obliged to satisfy specific laws and

regulations), how can our obligations be satisfied? How can compliance and AML personnel be of help? Technically it is impossible to address such questions in brief - as there are several regulations to consider and laws to abide by. However, perhaps it is ideal to start off by emphasising how essential it is to conduct Customer Due Diligence (CDD) and client screening, to better understand who we are dealing with. This process is also known as **Know Your Customer** (KYC). The scope of CDD and KYC is to determine who our clients are and the level of risk that servicing them poses to our company. The level of risk is determined by several factors which add up to a specific score based on the information provided on the KYC and CDD forms. Important questions include but are not limited to: the jurisdiction(s) a particular company is involved with, the nature of business, and whether the customer is a Politically Exposed Person (PEP).

Determining and verifying the source of funds (SoF) and source of wealth (SoW) of an individual or company is at the core of a KYC evaluation. At the outset of a business relationship, a subject person is to collect information on a customer's source of wealth and expected source of funds. To note that subject persons in line with FATF Recommendations should adopt a Risk-Based approach with respect to the amount of information collected for SoW and SoF purposes. The type of customer and the risk rating often entails different forms of Due Diligence. Thus, to conduct an effective review one must firstly understand what each of these phrases mean.

The term source of funds refers to "the origin of the particular funds or assets which are the subject of the business relationship or the transaction which is to take place". In simpler terms, for example, where is the client obtaining the funds to incorporate or run a company? Is it saved earnings derived through years of previous employment? Is it inheritance? The client must inform their service provider through the capture of a specific CDD form or questionnaire and support their replies with relevant documentation. For example, an individual is utilising funds obtained through the sale of a property to incorporate a new company. In such a case scenario, the individual prospect must present the Deed of Sale of the said property when completing the CDD form - to support the relevant information in this regard. Other documents are typically requested in such a case – for instance one must provide a bank statement showing the receipt of the amount of funds delivered into the account and, a recent bank statement showing the availability of such funding.

On the other hand, source of wealth refers to "the origin of the entire body of wealth of the individual". Therefore, the source of wealth does not only take into consideration the funds used to settle the transaction in question, but how the total wealth of the individual has been accumulated throughout the years. For example, this may emanate from sale of company shares or investments or it might be the case of family wealth or business activities – or an accumulation of employment income over the

years. Depending on the case, further documentation may be requested, such as a Source of Wealth Declaration, to better understand the accumulation of wealth of an individual.



In conclusion, subject persons (persons/organisations that are obliged to carry out CDD and KYC on customers who are seeking services determined as ‘relevant activities’ by law) and the KYC and CDD processes that they are obliged to carry out are crucial to enhance financial safety and minimise the level of risk posed to the service provider/subject person itself. Failure to do so may result in offences that are punishable by law – with many being punishable with wide ranging fines and other serious sanctions.

Thus, the compilation of CDD documents must be carried out correctly and cautiously displaying a level of maturity & honesty. The FIAU, MFSa and MBR as National Supervisors have released guidelines to guide subject persons on their obligations on this front. Lastly, verifying the source of wealth and the source of funds of a particular client is crucial to develop the Customer’s Risk Assessment (CRA). The Customer Due Diligence evaluation should be exhaustive enough to sufficiently provide for a complete portrayal of the customer which can be reviewed and understood in a logical and transparent manner by any Authority.

*\*The above-mentioned article is simply based on independent research carried out at DFK Malta Group of Companies. Accordingly, it is not intended to be provided by way of comprehensive and definitive advice.*