

## FSA CP11/12 Financial Crime: A guide for firms

### Introduction

AFME<sup>1</sup> and the FOA<sup>2</sup> welcome the opportunity to respond to the Financial Services Authority regarding the Consultation Paper 11/12 Financial Crime: a guide for firms.

*Q1: Do you support our proposal to publish the Guide. If not, why not?*

AFME and the FOA support FSA's proposal to publish the Guide as it will bring greater transparency regarding FSA's expectations of firms in regard to financial crime matters, the Guide will make FSA's material on the subject more accessible to firms and the Guide reinforces the importance that FSA attaches to financial crime issues. In addition, as many of our member firms are parts of large financial services groups located in various overseas jurisdictions, it will help clarify the expectations of the FSA and how those expectations may differ or coincide with other regulators. However, there are concerns that there may be scope for widespread confusion about the status of FSA's Guide in relation to the Guidance issued by the Joint Money Laundering Steering Group, particularly given that most of the latter's Guidance has been formally approved by Treasury Ministers; given the importance of this we trust that it will be possible to discuss this further with FSA.

We also note that the CP states:-

The Guide is not a checklist of things that all firms should be doing or not doing to reduce their financial crime risk, and will not be used as such by FSA supervisors.

The material in the guide does not form part of the Handbook, but much of it is guidance on rules and it is ~~general guidance~~ as defined in Section 158 of the Financial Services and Markets Act 2000. The guidance is not binding and we will not presume that a firm's departure from our guidance indicates that it has breached our rules. But we do expect firms to take account of what we say where

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<sup>1</sup> AFME (Association of Financial Markets in Europe) promotes fair, orderly and efficient wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association). For more information, please visit the AFME website, [www.afme.eu](http://www.afme.eu).

<sup>2</sup> The Futures and Options Association (FOA) is the industry association for more than 160 firms and institutions which engage in derivatives business, particularly in relation to exchange-traded transactions, and whose membership includes banks, brokerage houses and other financial institutions, commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options sector. [www.foa.co.uk](http://www.foa.co.uk)

it applies to them and to consider applicable guidance when establishing, implementing and maintaining their anti-financial crime systems and controls. Firms should expect us to check how that they can explain how they are complying with our rules and their other legal obligations, whether or not that involves applying good practice included in the Guide.

We believe that it is important that as FSA's Guide is updated over time, the status of the Guide should be confirmed in accordance with the statement above and this would ensure that the status of the Guide is not diluted as future versions are issued.

*Q2: Do you think the Guide will achieve our publication aims? If not, why not?*

Whilst AFME and the FOA believe the publication of the Guide will go some way to assist FSA in its publication aims, we feel that unless FSA and its successor, the Financial Conduct Authority (FCA), regularly emphasise the importance of financial crime issues, it may be the case that some firms will not devote sufficient focus or resource to them. We feel it is important for the FSA/FCA to keep these matters at the forefront of firms' attention through speeches, thematic reviews, conferences, regular Financial Crime Newsletters and updated Financial Crime Guides as necessary. It may be that in recent years, FSA's focus on prudential and financial stability matters has led to less of a focus on financial crime issues and, consequently, it is possible that some firms may have devoted fewer resources to the issues as well.

*Q3: Do you consider that the guide sets out with sufficient clarity which of its provisions apply to which firms? If not, how could we make it clearer?*

Whilst we believe that the Guide sets out which provisions apply to which firms, we believe that the *individual sections of Part 2* of the Guide should clearly state, as the sections in Part 1 do, to which firms FSA believes that the individual sections should apply.

Additionally, we note that FSA believes that the Guide will not be used as a checklist by FSA supervisors in their dealings with firms. It may become difficult for those supervisors not to rely on the Guide and use it as a checklist unless they receive high quality training on financial crime matters.

Equally, we believe that with some firms, particularly the smaller firms who have fewer resources devoted to financial crime, there will be a great temptation to use the Guide as a checklist and accordingly use the Guide as a minimum benchmark that will be adequate to meet FSA's expectations. Hence, we believe, FSA should encourage firms to adopt a more holistic approach to financial crime issues rather than a compliance- or tick box approach to the self-assessment questions and the examples of good and poor practice.

This is particularly so since, with the exception of the section on "countering weapons proliferation financing", the other sections are deemed to be relevant to all firms. While we appreciate that the paper is for a wide audience and covers a large and complex subject, it would be helpful if the guidance could give firms a clearer idea of what business models the FSA might consider to be most susceptible to particular financial crime risks, and therefore would warrant proportionately stronger measures to counter. For example, would the FSA consider the sections on AML and/or terrorist

financing be as relevant to a firm that does not hold client money as one that does? What examples of crystallised risk has the FSA observed in these respective types of firms?

*Q4: Is the Guide's structure and the use of self-assessment questions, good and poor practice and case studies, helpful and clear? How could we make it clearer or more useful?*

Whilst we believe the self-assessment questions, good and poor practices and case studies are helpful, we recommend that, in order to encourage firms to adopt a more holistic approach to financial crime matters, FSA provide more self-assessment questions under the various topics. However, as the Guide is targeted at FSA regulated firms that vary considerably in terms of size, complexity and geographic reach, we suggest that FSA, throughout the Guide, makes it clear that a firm's answers to the self-assessment questions will be heavily influenced by its own particular circumstances.

Further clarity could be provided around a number of examples of good practice so readers can better understand what that practice entails and how it might be applied at a firm. For example, the guidance gives "financial crime risks are addressed in a coordinated manner across the business and information is shared readily" as a good practice. It would be useful to understand how the FSA has actually seen this in practice in firms and which personnel have been involved? How do these firms take account of any data protection or client confidentiality considerations when sharing information?

With regard to the individual case studies, we were surprised to find FSA use the example of Lloyds TSB as case study in Section 4 of the Guide: Countering Terrorist Finance. Firstly, FSA did not find the firm guilty of any breaches of UK law or regulation, and secondly, in the recent thematic review of High Risk AML Situations, FSA was generally satisfied that the firms in the review were meeting their obligations under the Wire Transfer Regulations.

*Q5: What other comments do you have about the structure of the Guide?*

We have no other comments on the structure of the Guide.

*Q6: What comments do you have on the contents of the Guide? Do you have comments on the specific chapters or the annex of Part 1?*

- 1) *Introduction*
- 2) *Financial crime systems and controls*
- 3) *Anti-money laundering (including guidance arising from the AML thematic review)*
- 4) *Countering terrorist financing*
- 5) *Fighting fraud (including guidance arising from the mortgage fraud thematic review)*
- 6) *Data security*
- 7) *Combating bribery and corruption*
- 8) *Financial sanctions and asset freezes*
- 9) *Countering weapons proliferation financing*

## 10) Annex 1

Based on anecdotal evidence across a variety of AFME and FOA member firms they advised us that their staff are responsible for originating between 70 . 100% of Suspicious Transaction Reports (STRs) that are reported to the Serious Organised Crime Agency (SOCA) compared to those STRs that are generated by routine monitoring and general employees awareness, we recommend that greater focus is given in the Guide to staff training and awareness.

We also noted that in Part 2 that some of the examples of good and poor practices focus on staff training and awareness. It may helpful if the FSA demonstrates the importance of staff training and awareness by bringing these examples together in Part 1 in their own section.

As AFME members have some issues they would like to raise with FSA on the Politically Exposed Persons, AFME will be writing to FSA separately on this subject.

*Q7: Is the inclusion of part 2 of the guide useful? What comments do you have on its contents?*

We found the inclusion of part 2 to be useful.

*Q8: Are there topics not covered in the Guide which you would find it useful for us to address?*

There are many topics not covered in the Guide that we suggest that firms may find useful for the Guide to address:-

Market abuse: - We note that FSA specifically excludes in the Guide any reference to market abuse. We feel that one of FSA's objectives in producing the Guide, namely that firms can easily locate all of FSA's statements on financial crime, will be sub optimal in that firms who wish to locate FSA's considerable number of statement on market abuse will have to search the FSA website to locate them. As with many of our smaller member firms, MLROs also acting as Compliance Officers (CF10 and CF11s) will be responsible for all Financial Crime and Market Abuse matters.

We are also concerned that some may interpret FSA's deliberate exclusion of market abuse from the Guide as FSA not regarding market abuse as a financial crime and hence some firms may not give market abuse issues the focus they deserve.

We suggest that, at least, the Guide should refer to market abuse and provide a link to relevant FSA material on the matter.

Tax evasion:- By way of background, we have seen in recent years financial services firms outside the UK, some of whom have links to firms operating in the UK, being disciplined and being subject to ~~lawn~~ raids+ by host state authorities for actually facilitating tax evasion by their host state customers or being suspected of doing so. FSA will be aware that tax evasion is a predicate offence under the 3<sup>rd</sup> EU Money Laundering Directive and that the judgement in R v IK (2007) EWCA Crim 491 confirmed that tax evaded as a result of cheating Her Majesty's Revenue & Customs represents ~~criminal~~ proceeds+ as defined by the Proceeds of Crime Act 2002. Accordingly, a

regulated firm is required to submit an STR to SOCA where it suspects tax evasion. Furthermore, in the current financial climate, HM Government has launched a concerted drive against UK persons attempting to illegally evade their taxes.

We are aware of the proposition that firms may not be sufficiently aware of a customer's financial affairs to be able to detect potential tax evasion nor will Financial Crime departments be well versed in various tax laws that will allow them to detect tax evasion versus tax avoidance. Our member firms would welcome guidance on good and poor practice in managing the risk that they may be used unwittingly to facilitate tax evasion by their customers and clients, but it will be necessary, of course, to be realistic about what can be reasonably be expected of firms and, more specifically, the financial crime prevention departments.

Sanctions regimes . In Part 1 of the Guide, FSA include sections on Financial sanctions and asset freezes and Countering weapons proliferation financing, with the latter section focussing on nuclear, radiological, chemical or biological weapons. As FSA will be aware, the Department of Business, Innovation and Skills (BIS) maintains a licensing regime for conventional weapons and other items such as dual use goods which may both have civil and military uses.

Our member firms, to the extent that they offer trade finance services or credit to customers involved in transactions of goods and services subject to the BIS licensing regime, may have to be satisfied that the appropriate export/import license has been obtained from BIS by their customer, for example, where the customer trades in proscribed goods, otherwise the firm may unwittingly be involved in an arrangement involving criminal proceeds derived from an unlicensed transaction in restricted goods or services. Such member firms would welcome guidance on the extent to which firms should seek confirmation that their customer has the appropriate license and the extent to which firms should provide high level training to relevant staff on the UK's export/import licensing regime.

Risk assessment: - Many of our member firms who are located in the UK are owned by foreign entities who will have their Group Head Office outside the UK. Consequently, such firms are ultimately lead regulated for AML and CTF purposes by an overseas regulator. FSA will be aware that, in terms of AML and CTF, financial services groups - regardless of the home jurisdiction - will generally have to conduct a group wide AML/CTF risk assessment. It is often the case though for some of our foreign owned UK members, that their UK operations and activities, whilst significant in themselves, are often less than material when considering the AML/CTF risk for the group *as a whole*. Hence, it is possible, therefore, that the AML/CTF risk of the UK firm on a standalone basis is not given due weight by the Corporate Group as a whole. In other words, there is a risk that, from the Group viewpoint, the AML/CTF risk of the UK operation will be deemed to be immaterial, whereas when considered on a standalone basis, it may be material.

Our members would welcome guidance on good and poor practice on the risk assessment of UK units of foreign owned firms, particularly where the UK operation is smaller, relative to the Group, and/or where the UK operation offers distinct services when considered from a Group viewpoint.

Reliance on Group Companies: - Many of our member firms are parts of large financial services groups. It is often that case that many functions related to financial crime such as customer take on, transaction monitoring and data processing and storage are undertaken on behalf of the UK firm by other companies in the Group, who may be located outside the UK. As a result, there are often a multiplicity of laws and standards that the Group service company has to operate under.

Accordingly, our members would welcome guidance on the extent to which UK firms are able to use Group companies to perform certain tasks and the degree to which the UK firm should satisfy itself that the Group company is meeting standards equivalent to UK regulatory requirements in performing those tasks.

*Q9: What comments do you have on our assessment of the equality and diversity issues we have identified?*

We have no comments on this question.

*Q10: Do you have any comments on this cost benefit analysis?*

Our members are not in a position to comment on the cost benefit analysis.

## **Conclusion**

We would be pleased, of course, to discuss the issues covered in this submission with FSA or to provide further information about any of the matters which our Members have raised if that would be helpful.