CNBV Workshop on AML and CFT
Mexico City, 8-9 September 2015

The FCA’s risk based approach to AML supervision

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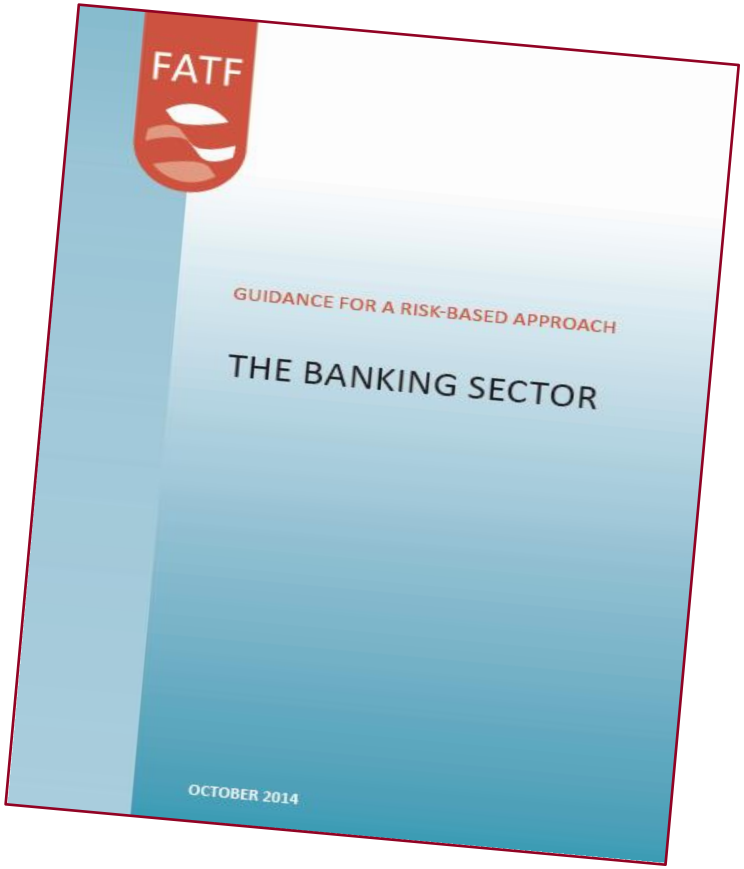
The aim of this session……

- To discuss how the UK implements a risk based approach to AML supervision and enforcement
- Even more importantly, to share knowledge in relation to the <u>effectiveness</u> of differing supervisory approaches and some of the emerging risks facing the AML regulatory landscape
- So first I will talk about what a risk-based approach means
- Then I'll tell you how we seek to implement it in the FCA

The risk-based approach: legal and regulatory foundations in the UK

- FATF recommendations and guidance
- The Money Laundering Regulations 2007
- FCA rules and principles
- JMLSG Guidance
- FCA Guidance: *Financial crime: a guide for firms*



A view from a UK AML regulator

- Supervising firms: the risk based approach (RBA)
- Role of the FCA
- Systematic Anti-Money Laundering Programme (SAMLP)
- What we are finding in firms
- Responding to failures: remedial action and enforcement
- Working with our global partners
- Emerging risks and other hot topics

What is a risk-based approach? (1)

- The risk-based approach is a means of allocating supervisory resources. We can target our efforts to where risks are greater

- The risk-based approach answers these questions

"How do we allocate the resources we have?"

"Do we have sufficient resources, given the risks?"

- These questions apply to regulators and industry.

What is a risk-based approach? (2)

Building blocks

- Thorough understanding of risks, reviewed regularly
- Regulatory focus on principles
- Realistic and reasonable

Benefits

- Focus on real crime reduction, not tick box compliance
- Flexibility in relation to evolving risks

Limitations

- Some minimum standards and absolute requirements
- Not likely to reduce resource/skills requirements in regulators or firms

Alternatives?

Challenges for regulators using the RBA

- Skilled and well-informed staff (so attractive to banks)
- Good judgement
  - Some firms' practices may differ from peers'
  - Is this reasonable or reckless?
  - Is one approach more effective than another?
  - How do we deal with rapid changes in markets/technology?
- Guidance for the industry

Financial firms and the RBA

- The RBA can apply to a range of key AML activities, including:
  - CDD
  - transaction monitoring
  - training
  - procedures and controls
  - internal audit/compliance monitoring

- The approach firms take should be based on a sound enterprise-wide risk assessment

- Higher risk areas should be clearly identified and subject to enhanced procedures

Supervising firms: the RBA (1)

	Low Risk	High Risk
Customer base	Stable and known	Rapid growth of customer base into new markets
Customer origin	All are domestic	Many international from high risk jurisdictions
Customer type	No higher risk categories	Cheque cashers, convenience stores, Politically Exposed Persons (PEPs), money remitters, import/export business
Distribution	All face to face business	Variety of products sold via internet and telephone

Supervising firms: the RBA (2)

	Low Risk	High Risk
Correspondents	No correspondent banking relationships	Many correspondent banking relationships (including with banks with poor AML controls)
Products and services	No higher risk products or services	Offers private banking, non discretionary asset management, trust services etc.
Fund transfers	Limited number of fund transfers for customers, all transfers are domestic	Many non-customer fund transfers, including some higher risk countries and tax havens.
Staff	Low staff turnover, thorough and well documented training	High staff turnover, training has struggled to keep up.

Illustrative example: PEPs

- Desired outcome - firms spotting corrupt payments or the laundering of the proceeds of corruption or other crime
- Strict legal definition of PEPs in UK ML Regulations and special measures needed
  - Senior management approval
  - EDD including on source of wealth
  - Enhanced monitoring
- Some questions to consider under the risk based approach
  - Are banks taking a rigorous approach when assessing risks presented by profitable customers?
  - Does a PEP's influence really end after a year?
  - What about more distant relatives/associates?

Role of the FCA: our remit

We supervise around 70,000 firms. Most of these are subject to our financial crime (but not all to AML) rules.

Single strategic objective:

- To ensure that the relevant markets function well

Three operational objectives:

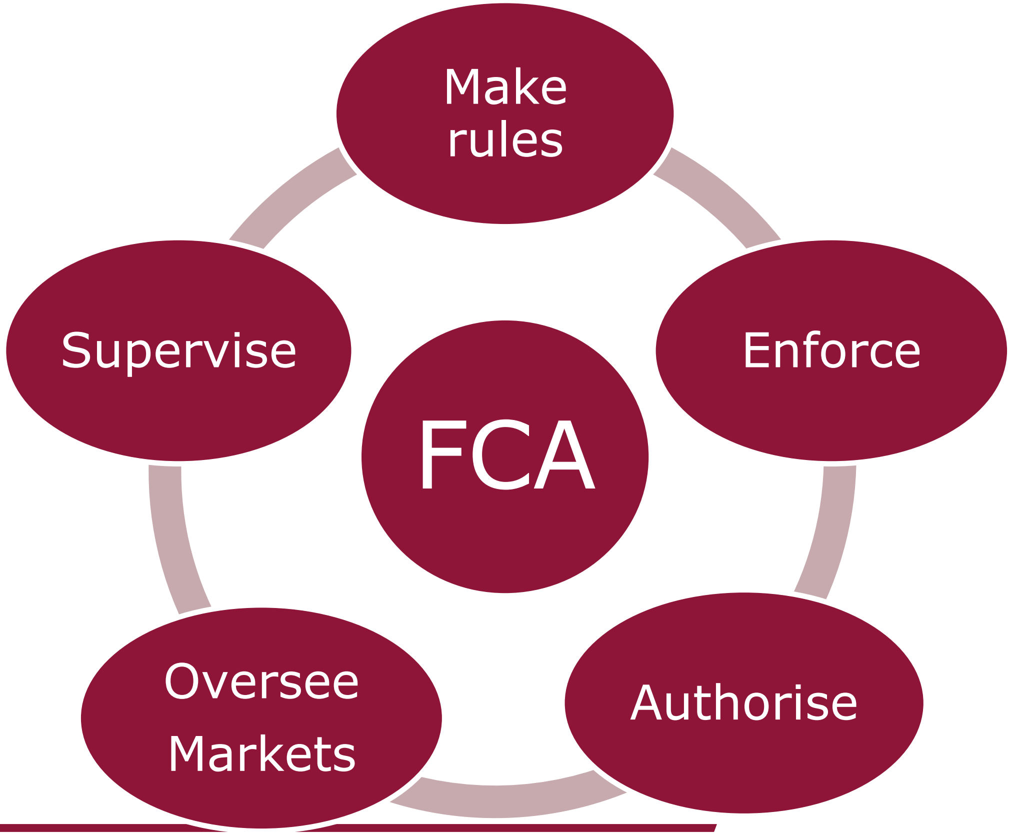
- Secure an appropriate degree of protection for consumers;
- Protect and enhance the integrity of the UK financial system;
- Promote effective competition in the interests of consumers.

Our financial crime duty is to:

Protect and enhance the integrity of the UK financial system so it is not being used for a purpose connected with financial crime. We have a general duty to take action to minimise the extent of financial crime.

Role of the FCA: our powers

We have rule-making, investigative and enforcement powers that we use to protect and regulate the financial services industry and support the delivery of our financial crime objective.



Role of the FCA: our AML philosophy

- To ensure that firms have the right systems in place to stop proceeds of crime flowing through the UK. Areas covered through our active financial crime supervision include:

  -money laundering
  -terrorist financing
  -bribery and corruption
  -data security
  -sanctions breaches

- We supervise around 15,000 firms for AML purposes, under the UK's Money Laundering Regulations.

- The FCA approach:

  - Forward looking
  - Judgement based decisions and early intervention

FCA approach in practice

- Dedicated Financial Crime Department, including specialist supervision team, policy team and risk team and regular cross-FCA reviews of financial crime risk. Significant increase in resource in recent years

- Our prioritisation/risk assessment informed by:
  - (in future) the UK's National Risk Assessment
  - national and international findings/typologies
  - intelligence assessments
  - our own experience, casework etc

- Key types of AML work
  - Advice/support from specialists for line supervisors conducting AML work
  - Reactive casework
  - Thematic work – focus on highest risk financial crime issues/sectors
  - Systematic AML Programme for largest higher risk firms and new ML2 Programme for smaller firms presenting higher ML risk
  - Range of tools to tackle weaknesses, including enhanced supervision, early intervention, formal Enforcement investigation

Case study: our use of thematic work on AML

- Key FSA supervisory tool - sets out our assessment of the industry's performance and examples of good and poor practice
- Incorporated into our document *Financial Crime: A Guide for Firms*, as formal FSA Guidance
- Recently published AML thematic reviews:
  - AML risks in trade finance (2013)
  - AML and ABC controls in asset managers (2013)
  - How small banks manage money laundering and sanctions risk (2014)
- Earlier AML thematic reviews:
  - Banks' management of high money laundering risk situations (2011)
  - Banks' defences against investment fraud (2012)

Banks' management of high money-laundering risk situations

- First review of this issue (2011)
- Very serious weaknesses found in AML controls over high risk/PEP customers
- Some banks apparently unwilling to exit very profitable business when the ML risk was unacceptably high
- Likely that some banks were handling the proceeds of corruption
- A number of Enforcement actions followed

http://www.fsa.gov.uk/pubs/other/aml_final_report.pdf

How smaller banks manage money laundering and sanctions risk

- Follow up to earlier review, published in 2014, looking at smaller wealth management/private banks, wholesale and retail banks
- Some had effective AML/sanctions controls; higher standards in private banks. Senior management engagement had improved
- But we found significant and widespread weaknesses in key controls, and a third had inadequate AML resources
- Particular challenges in foreign-owned banks, where Group policies and procedures were inconsistent with UK requirements
- Outcomes: particularly serious issues at 6 banks: enforcement investigations at 2 banks; 4 banks agreed to voluntary restrictions; 3 were required to appoint a Skilled Person to conduct a more detailed review; 3 undertook remedial work

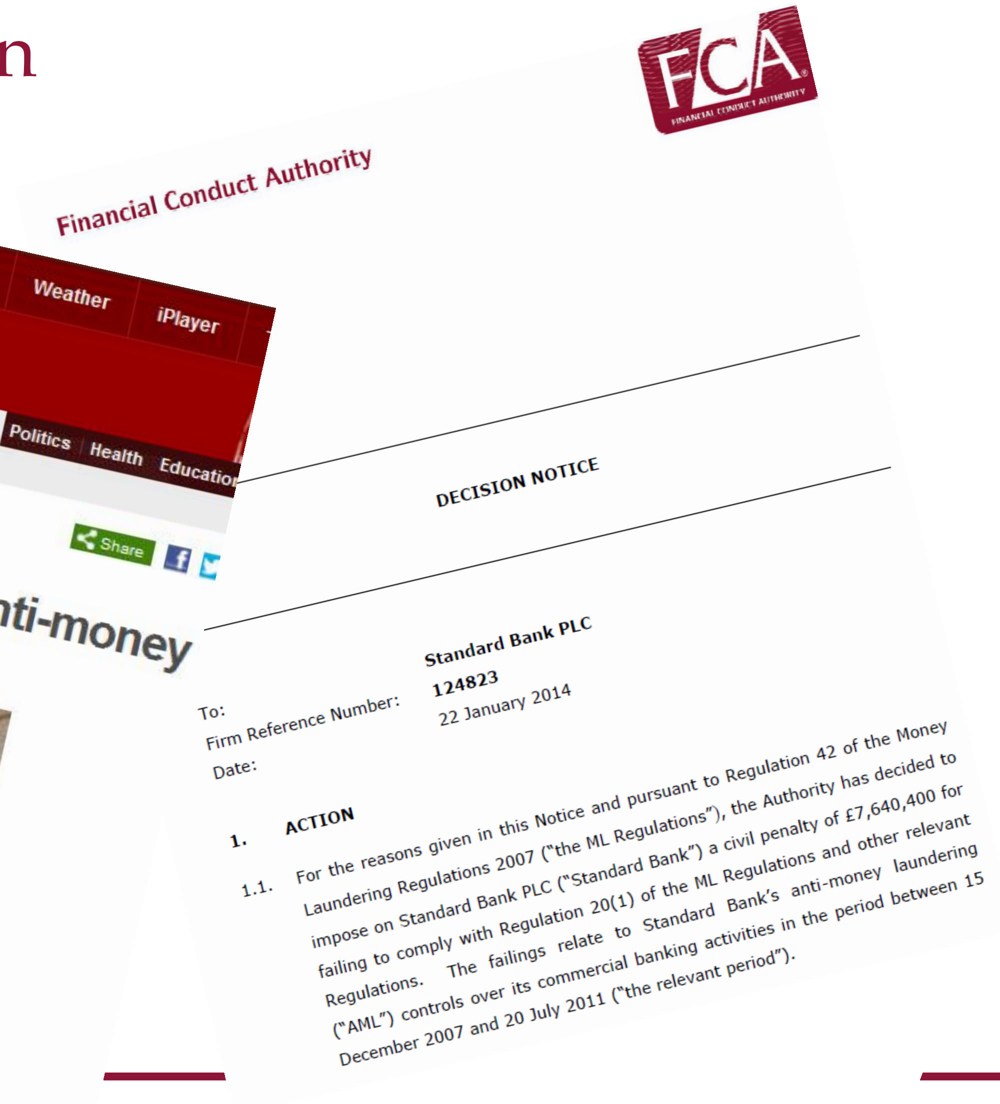
http://www.fca.org.uk/static/fca/documents/thematic-reviews/tr14-16.pdf

Responding to serious failings: taking Enforcement action

- **High risk customers/PEPs**
  - 2012 – Coutts & Co - £8.75mn
  - 2012 – Habib Bank AG Zurich - £525k and its MLRO - £17.5k
  - 2013 - EFG Private Bank - £4.2mn
  - 2013 - Guaranty Trust Bank - £525,000
  - 2014 - Standard Bank - £7.64mn
- **Correspondent banking**
  - August 2012 – Turkish Bank (UK) Ltd - £294k

- *All these fines reduced by a 30% discount for early settlement*

Responding to serious failures: taking enforcement action



Financial Conduct Authority

FCA FINANCIAL CONDUCT AUTHORITY

DECISION NOTICE

To:	**Standard Bank PLC**
Firm Reference Number:	**124823**
Date:	22 January 2014

1. ACTION

1.1. For the reasons given in this Notice and pursuant to Regulation 42 of the Money Laundering Regulations 2007 ("the ML Regulations"), the Authority has decided to impose on Standard Bank PLC ("Standard Bank") a civil penalty of £7,640,400 for failing to comply with Regulation 20(1) of the ML Regulations and other relevant Regulations. The failings relate to Standard Bank's anti-money laundering ("AML") controls over its commercial banking activities in the period between 15 December 2007 and 20 July 2011 ("the relevant period").

How can regulators learn from each other?

Working with our global partners

FCA engagement with international and European partners

Global level

IOSCO / Financial Stability Board / IAIS / FATF

European level

EU Commission / Parliament / Council

ESMA / EBA / EIOPA

National regulators

Cooperation and engagement with national authorities to enable cross-border supervision and enforcement actions

The future

- Continued UK Government focus on financial crime
- Continued strong FCA focus on financial crime issues, including at top level
- New EU 4th Money Laundering Directive expected to be implemented in 2017. Working with Treasury to transpose into UK law. New Directive further embeds risk-based approach
- We continue to refine use of supervisory/enforcement tools to improve industry behaviour
- Continuing with SAMLP and ML2 programmes
- Continued use of thematic reviews
- Strong focus on ensuring controls are adequate while discouraging wholesale 'derisking' of entire sectors or countries