

Industry Seminar – 16 November 2016

Financial Crime Supervision and Policy Division Presentation

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Slide: Good Compliance Culture

Good morning. Today I would like to set out some examples of good and poor compliance culture which we have seen from our engagement with firms during the last 12 months.

Understanding your risk appetite is key. We have noted from our engagement with firms that those firms who can clearly articulate their risk appetite are also the same firms which put in place strong policies, procedures and controls to mitigate the risks of money laundering and terrorist financing.

This is why the Commission has placed great emphasis on a firm's Business Risk Assessment and the articulation of their risk appetite. The Commission does not take issue with firms administering high risk business so long as they put in place appropriate controls to mitigate the risks.

When undertaking an on-site visit to a firm a large proportion of the visit is devoted to understanding a firm's risk appetite and assessing what type of business a firm would be willing to accept. We also assess whether the evidence found on client files aligns with the Board's perception of its risk appetite.

Where there is a disconnect between what the Board believes and what the business actually does will invariably lead to enhanced supervision by the Financial Crime Division or referral to the Commission's Enforcement Division for further investigation.

As Fiona stated earlier, the Financial Crime Division endeavours to engage with up to 50 firms per year and the large majority of these firms have demonstrated a good compliance culture.

For example, we visited a firm that identified in its Business Risk Assessment that a large proportion of its clients were high risk. As a result the firm has a rigorous enhanced CDD onboarding procedure.

The firm informs potential high risk clients that they will conduct enhanced CDD and this may take time. They also inform potential clients that they will be charged for the enhanced CDD, this differs to many Firms who charge a fixed rate plus time spent. The issue with charging on

a time spent basis is that on the less active clients there can be less incentive to do compliance, notwithstanding that these less active client can still be high risk.

Charging a specific fee for enhanced CDD means that the firm is able to conduct detailed due diligence rather than the bare minimum as seen with set fees. This firm demonstrated that it was prepared to go through extra lengths to understand their clients and their source of wealth even on less active customers.

The Firm also advised us that their clients did not mind paying this extra fee because they considered they received a better service and in one case a sophisticated fraud was stopped because that Firm knew their client so well.

Whilst, it is not for the Commission to direct firms on how to run their businesses we consider that this is an excellent example of good practice in relation to the management of high risk relationships.

Equally, we have visited a number of firms that have a low risk appetite and have clearly demonstrated that they are not willing to accept high risk business. Here are a couple of examples: -

One firm was approached by an individual who wished to set up a trust structure. The individual wanted to use a number of companies with activities in the West African oil & gas industry. However the purpose, complexity and rationale for the structure was not clear to Firm. Furthermore, the individual was evasive with information and did not want to provide personal data, which was necessary for the Firm to conduct CDD. The Firm was also unable to ascertain his source of wealth.

As a result the Firm declined the business. It is evident that this firm was clearly alive to the risks of bribery and corruption posed by this potential client.

Another firm was introduced to a client by a firm in relation to the financing of an airport. However, the CDD was provided in small amounts and the Firm spent a lot of time attempting to piece together a clear explanation for the confusing structure, funding and ownership.

The Board of Firm decided that the high level of enhanced due diligence and the resources required to conduct this did not fit within the Firm's risk appetite. Accordingly, this firm declined this business and logged this information in their declined business register. It is clear that this firm was concerned that this client could subject them to tax evasion, bribery and corruption risks.

What is also apparent from these two examples is that both of these firms declined the potential business because they could not understand the economic or other commercial rationale and ultimately these clients did not fit within their risk appetite.

Ongoing monitoring of business relationships, in particular transactions and adverse media screening is one of the most important aspects of effective ongoing CDD. It is encouraging that

the majority of Boards have a demonstrable awareness of financial crime risks and are supportive of strong preventative measures.

For example, one firm identified that the traditional method of monitoring transactions was not sufficiently robust to monitor the potential money laundering risks that the Firm was exposed to.

Previously the firm's system flagged frequent transactions over £10,000, which is a commonly used threshold, however, this would enable an individual to send £9,999 whilst remaining under the radar.

Furthermore, some firms only monitor large transactions each month enabling an individual to 'smurf' £10,000 on the 31st and £10,000 on the 1st of the following month.

However, this firm recognised these weaknesses in its Business Risk Assessment and created a rolling average of transactions to determine any anomalies.

Slide: Poor Compliance Culture

Firms often ask us for examples of poor practice and we could think of no better way of relaying these to you other than my colleagues and I performing a role play.

Today we have for you a 20 minute video divided into 3 scenes. The first scene is the opening meeting between the Commission's supervisors and the management team of a fictitious firm called Salarie Financial Services.

The second scene shows the supervisors discussing the results of their client file reviews amongst themselves and the final scene is when the supervisors discuss their initial concerns with the Firm's management team.

The issues raised in this case study are real – references to brown paper bags filled with cash and arms trading are true but anonymized. I am glad to say that not all of the issues raised in this video belong to one single firm. Whilst some of the acting is somewhat exaggerated for entertainment purposes I hope you find the key messages useful.