

Industry Seminar – 23 November 2017

Financial Crime Supervision and Policy Division Presentation

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Good morning ladies and gentlemen.

Before I release the world premiere of Season 2 of Salarie Financial Services, I would like to share with you some practical examples of how to mitigate financial crime risks.

Slide: Guidance and Feedback

At the last industry presentation, I stated 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. Today, I would like to develop that theme further.

We acknowledge that it's highly unlikely that firms can make money without taking risks, therefore Boards must ensure that they put in place proportionate systems and controls, to mitigate identified risks, and in particular, from my perspective, financial crime risks, both at the front line, that is your operations and business units, and the second line, that is your compliance and risk units.

However, Boards should not only identify financial crime risks, and put in place relevant systems and controls, they also need to ensure that they receive appropriate management information, to enable them to adequately oversee their business and ensure that the controls are working.

Slide: Financial Crime Governance, Risk and Compliance

Hence, this is why we undertook a thematic review of the Financial Crime Governance, Risk and Compliance frameworks, at fund administrators and managers at the end of 2016, and extended this to fiduciaries this year.

I am glad to say that the thematic review of smaller fund firms generally indicated that there was a culture of compliance, that is, firms had put in place compliance monitoring programmes, which covered a broad range of tests, and Boards were receiving regular compliance and risk reporting, enabling them to oversee the business appropriately. I would encourage you to review the full report which is on our website.

Slide: Regulatory Self-Assurance

However, there are four areas with scope for improvement which could apply to all regulated firms, which I would like to run through today.

These four areas are detailed on the screen, and in the self-assurance help sheet, which has been provided to you for you to take back to your office, and discuss with your colleagues. We are not expecting these forms to be returned to us, they are purely for your benefit.

In the meantime you might want to reflect on how you are doing in comparison with what I'm about to say.

Slide: Mitigation of identified risks

We identified that with some firms there was a disconnect between the risks identified by the Board on one hand, and the mitigation of those risks on the other hand.

For example, a firm had identified bribery and corruption risk as inherently high to its business, but the compliance monitoring programme did not have a specific test to cover bribery and corruption. Bribes can often be disguised as commissions or consulting fees, therefore, compliance tests could be applied to payments out of the scheme property.

Of the 10 firms we visited, 6 had compliance monitoring programmes which did not fully take into account the risks identified by the Board in the Business Risk Assessment. Of these 6 firms, 5 had outsourced their compliance function to a third party compliance firm, implying that a generic monitoring programme had been provided to the firm, without any subsequent revision to reflect the nature of the firm's business model, and the financial crime risks associated with that business model.

We have also identified a similar issue from our thematic review of fiduciaries. For example, we came across one fiduciary which was testing whether it had an MLRO, which is quite bizarre, bearing in mind the MLRO was the one conducting the actual test.

Slide: Sanctions, Payments and Adverse Media Screening

I would like to reaffirm that we have no objection to the use of outsourced compliance providers, however, you must ensure that the Business Risk Assessments, and compliance monitoring programmes, are relevant to your business.

For example, you would not buy an off-the-shelf IT system without checking that it is compatible with your existing systems, therefore I would encourage Boards to check that their compliance monitoring programmes focus on the areas which they perceive to cause the greatest risk to their business, and are not simply tick box exercises.

Whilst 100% of the firms sampled are monitoring sanctions, a number of firms rely on automated sanctions screening systems, of which one firm in our survey did not undertake any tests, to assess if the automated screening processes was operating correctly. Automated systems are only effective if the IT programmes supporting them have been correctly configured.

I am drawing this issue to your attention because it is not an issue isolated to the thematic. A number of firms who rely on automated sanctions, payments and adverse media screening systems have subsequently found that their IT systems are not operating correctly.

Examples we have seen include: a system which pulled data from a historic client database, and on another occasion the payment screening software had been switched off for a specific type of payment. I would therefore ask all firms who use automated systems, to ensure that those systems are subject to regular testing by your internal audit and/or compliance function.

Slide: Board Oversight

Whilst it was evident that firms were regularly reviewing their compliance arrangements and noting tabled compliance reports, Board minutes for some firms, did not reflect the Board's consideration of AML/CFT risks. In this regard, the Board minutes only recorded that compliance matters such as AML/CFT training, conflicts of interest, gifts and that the compliance report has been noted with no record of what those discussions were. I would ask Boards to consider how they would show that they take compliance with the AML/CFT legislation seriously.

Half of the firms visited did not include in their compliance report to the Board, information on the time taken between an internal disclosure, of a suspicion of money laundering or terrorist financing to the MLRO, and the decision by the MLRO as to whether to report the suspicion to the FIS. Suspicions of money laundering and terrorist financing must be disclosed as soon as possible to the FIS, in order not to delay, or hinder an investigation, into potential criminality by the law enforcement authorities. I would therefore encourage Boards to consider how they satisfy themselves that their MLRO is making suspicious reports on a timely basis.

Slide: Salarie Financial services – Season 2

Last year, we introduced to you a fictitious firm called Salarie Financial Services, which amalgamated the worst CDD deficiencies from various firms we have visited since the Division was created in 2012. I am pleased to announce that Salarie Financial Services is returning today, albeit the culture of the firm has noticeably changed, in some respects, but in other respects, further work is required. My character has reformed, but rest assured some of Nick and Andy's old habits die hard.

To set the scene, the poor practices identified by the onsite team when visiting this fictitious firm resulted in sanctioning by the Commission, and also the imposition of various risk mitigation

programmes to reduce the risks identified by the Commission. Therefore, the onsite team are returning to Salarie Financial Services to assess how they are getting on with remediating the issues.

[Video clip]

As before the acting is somewhat exaggerated for entertainment purposes, but we hope you will find the key messages useful. The 15 minute clip we are about to show you will expand on the issues of risk appetite, risk mitigation and Board oversight that I discussed earlier.

Finally, Fiona and I would like to express our appreciation to our colleagues for taking part in this production. Following the film Fiona and I are happy to take questions.