



## **Feedback on DP22: Reducing money laundering risk: Know Your Customer and anti-money laundering monitoring workshop**

### **Introduction**

On 19 August 2003 the Financial Services Authority (FSA) published **Discussion Paper 22: Reducing money laundering risk: Know Your Customer and anti-money laundering monitoring (DP22)**. In our press release we announced that we would hold a roundtable discussion to discuss the issues and options set out in DP22. The DP can be found on our Website at <http://www.fsa.gov.uk/pubs/discussion/22/>.

### **What are Know Your Customer and monitoring?**

The Money Laundering Regulations 1993 (and the Regulations 2003 when they come into force on 1 March 2004) and our rules require firms to have adequate systems and controls for anti-money laundering purposes. DP22 discusses two important anti-money laundering controls that may help firms to manage their money laundering risk. **Know Your Customer (KYC)** is the collection and use of information about a customer over and above the collection of basic evidence of identity like passports, driving licences and utility bills and **monitoring** means firms being alert to how a customer is using its products and services and therefore to signs of money laundering to improve Suspicious Activity Reporting to the National Criminal Intelligence Service (NCIS).

### **DP22 roundtable**

We held a **half-day workshop on Tuesday 11 November 2003** at the FSA. Over 60 organisations with an interest in anti-money laundering were invited to participate, including representatives from government, law enforcement agencies, the Joint Money Laundering Steering Group (JMLSG), trade associations, firms from different financial sectors (retail/non-retail, small/large, bank/non-bank), transaction monitoring service providers and credit reference agencies. A list of participating organisations is set out in **Annex 2**.

### **Purpose of this paper**

This provides feedback on the key points raised at the workshop. No comments have been attributed to specific individuals or organisations. We would like to thank all participants for their enthusiasm and input into the workshop.

## **Reasons for having the workshop**

The workshop objectives were to:

- give participants a broad understanding of government and regulatory anti-money laundering objectives and priorities;
- identify relevant industry anti-money laundering issues;
- highlight some of the important anti-money laundering challenges ahead;
- help stakeholders to think about how relevant KYC and monitoring may or may not be in managing their financial crime risks; and
- find out which of the options for FSA action set out in DP22 were preferred and why.

## **The workshop**

The workshop started with presentations by the Home Office, FSA and PricewaterhouseCoopers. These provided participants with an overview of the UK's anti-money laundering regime from a government, regulatory and independent perspective and to highlight important topical anti-money laundering issues.

Participants were then split into 5 discussion groups (Red, Blue, Green, Yellow and Orange). Each group had a mix of representatives from government, law enforcement, trade associations, firms and FSA. Each group was asked to consider the issues and questions raised in DP22 and to provide feedback to the workshop on a specific question. The feedback was then discussed in an open forum. The questions guidance of the group and feedback from them are set out in **Annex 1**.

## **General feedback**

The main general points made at the workshop were:

- the implications of KYC and monitoring for firms depend on the kind of business they do.
- there are strong risks of uncertainty high expenditure by firms because of defensive and conservative attitudes to legal and regulatory risk.
- feedback from law enforcement on real experience of crime, money laundering and terrorism is important to a risk based approach.
- the implications are different for large firms and small firms
- industry guidance through the JMLSG and trade bodies is vital
- the case needs to be made to persuade senior management of the value of additional expenditure on anti-money laundering
- most of the attendees favoured Option 3 (rely on JMLSG Guidance Notes) or Option 4 (review again in two years time) to Option 1 and Option 2 (new rules and guidance)

## **Response period**

**The closing date for responses to DP22 is 30 January 2004.** We would encourage firms to respond either individually or through their trade associations. It is important that we receive responses on the questions and options raised in DP22. This will help to ensure that our approach is proportionate across the regulated financial sector. We would also encourage responses from other stakeholders, such as providers of transaction monitoring systems, credit reference agencies and anti-money laundering specialists and consumer groups.

## **Next steps**

We will publish a formal **Feedback Statement** in the spring explaining the responses we received and our decisions regarding the options set out in DP22.

## **Annex 1**

### **Red group**

**Question: how should firms pursue a risk-based approach to anti-money laundering?**

**How important is a risk-based approach for prioritisation and cost control?**

- The risk-based approach is important for prioritisation - prioritising risk is the driver for the allocation of resources and cost.
- There is a difference between the way small and large firms approach the risk-based approach - small firms can view the risk assessment process as difficult or problematic in itself and decide to class all their business as high risk, so conducting a high-level of due diligence on all their customers to avoid making mistakes and incurring regulatory sanctions; this is likely to lead to disproportionately intense anti-money laundering effort.
- Firms are not necessarily looking for the lowest anti-money laundering costs - firms want costs to be proportional to the risk. A firm should also be free to assess the risk for itself. It would be beneficial if the FSA were to give greater assurance that a firm is free to assess the risk for itself and that regulatory sanctions would be unlikely even if the FSA were to disagree with the firm's approach. This would counteract the risk of over-defensive compliance measures by firms.
- The private sector invests more than the public sector, NCIS or law enforcement in controls to tackle money laundering – firms would like to see a proportionate investment between private and public spending.
- It is difficult to apply a risk based approach to terrorist financing because it is not like criminal money laundering and there is not enough information about terrorist financing.

**How straightforward is a risk-based approach within the present legal framework?**

- It is questionable if the UK's regime is truly risk-based because firms do not have the information to assess the risks for themselves and because the law requires them to have a certain level of controls even if the business is considered very low risk.
- The tensions created by the different pieces of legislation like anti-money laundering and data protection has created defensive attitudes and behaviour and this coupled with heavy penalties for getting things wrong makes firms defensive, in particular their reporting to NCIS.

**How can firms' best understand what their risks are?**

- More analysis of the risks to specific financial sectors would be very valuable to firms - seeing trends and patterns etc would help individual firms to assess their own risks.
- Trade associations have a role to play in helping to assess the risks of money laundering within specific sectors.

### **What role can NCIS and law enforcement play?**

- Firms would like more informed and timely feedback from NCIS and law enforcement agencies because they are the only ones who really know where the crimes are taking place and where the risks of money laundering are.
- The amount of money being laundered in the UK is unknown therefore the figures used by government and law enforcement are meaningless – we should stop focusing on the figures and focus on the areas at risk from money laundering.
- Firms would find it beneficial to know how specific sectors are being targeted, where the real threats are, who the people are that are likely to be laundering money. Firms also want law enforcement to help them to identify and treat Politically Exposed Persons (PEPs) in meaningful and sensible ways i.e. knowing at what stage someone becomes an undesirable customer and at what point a firm should stop doing business with them.

### **What role can the JMLSG Guidance Notes play?**

- The Guidance Notes should be focused on giving practical guidance to informed MLROs. They need to be short and succinct and to be able to assist MLROs to deal with practical problems by knowing what good industry practice is for different situations.

### **What role can Trade Associations play?**

- Trade Associations can work in partnership with industry, individual firms, the FSA, law enforcement and government.
- Because they are not subject to regulation or oversight Trade Associations can provide a useful mechanism to inform the FSA and government when the regime is not working as well as it should.
- Trade Associations can help by informing their member firms of important FSA and government messages.

## **Blue group**

### **Question: what are, or may be, the costs and benefits of KYC and monitoring?**

#### **To what extent are KYC and monitoring costs additional to what firms need to spend in their own interests?**

- It is very difficult to assess the costs and benefits of KYC and monitoring in managing money laundering risk.
- The additional costs of KYC and monitoring will differ greatly depending on the type of business a firm does.
- In addition what a firm does for anti-money laundering purposes, KYC and monitoring are also used to prevent and detect fraud to protect the firm and consumers from suffering losses.

**To what extent will KYC and monitoring costs add to the costs of identification and other basic anti-money laundering controls?**

- The cost of KYC requirements may be viewed as an extension of what firms might require for their own core business needs. The additional cost of KYC will then depend on the expected verification level of KYC information.
- The cost of monitoring will vary considerably depending on the type of business a firm does.

**What are the main cost sources (IS systems? People? Senior Management? Training?)**

Difficult to identify the main cost sources, however,

- The extra costs associated with KYC and monitoring will be passed on to the customer.
- KYC information may be intrusive and may damage the firms' relationship with its customer's.

**What are the main benefits of KYC and monitoring?**

Difficult to identify the main benefits, however,

- More feedback from law enforcement agencies would help to make the benefits clear. i.e. where the real risks of money laundering are.

**How can the benefits be increased?**

- In a risk-based environment firms assess risk differently – therefore customers who buy the same product from different providers have different experiences.
- Improved guidance would be useful to assist the industry to be consistent in how it assesses risk which would benefit consumers by managing their experiences.

**To what extent are the benefits for firms, to what extent for law enforcement, to what extent for society generally?**

The benefits are difficult to identify, however,

- The role of commercial businesses in society is to provide financial services to society - not to detect every money launderer and terrorist. But,
- The role firms play in assisting law enforcement agencies is important and it is also beneficial to firms and society.

**Green group**

**Question: please consider the collection, in addition to basic identification, of KYC information (e.g. information about source of funds, reason for establishing the business relationship income etc.) in managing the risk of money laundering and complying with the Proceeds of Crime Act or the Money Laundering Regulations?**

**How important is this for identifying unusual transactions? Or for assessing the risk attached to particular customers?**

- In a risk-based approach KYC is particularly important to determine the risks attached to customers, in particular whether a customer is high risk.
- KYC is a vital tool for identifying unusual transactions - firms need more than the basic identification requirements to determine whether a transaction is suspicious or not.

### **Is KYC relevant only for higher risk situations, such as ...?**

- The collection of KYC information is important to determine risk - a basic level of KYC is therefore always required.

### **What are or may be the difficulties in obtaining and using KYC information? e.g.**

- the difficulty of keeping information up to date?
  - the problem of verifying information?
  - cost?
  - the need to maintain data protection standards?
  - the need to retain consumer confidence?
- Firms' senior management see KYC as part of anti-money laundering controls and in isolation from other prudential controls e.g. fraud or credit risk.
  - Firms want to comply with the law and the Regulations but do not see KYC for anti-money laundering purposes as their highest priority to spend money on - linking anti-money laundering requirements with the wider financial crime objective may help firms' senior management to see the benefits of KYC to the whole organisation.
  - The cost of KYC would depend on the amount of KYC information a firm was required to obtain and verify - a high level of basic KYC verification would have serious cost implications for firms' e.g. adequate resources, staff and systems.
  - It is difficult to keep KYC information up to date because of the costs involved.
  - A risk-based approach is beneficial to firms. However, setting a minimum standard of KYC may assist in reducing inconsistencies.

## **Yellow group**

**Question: Please consider an active approach to monitoring (that is firms being alert to how customers are using their products and services and to signs of money laundering) in managing the risk of money laundering and complying with the Proceeds of Crime Act or the Money Laundering Regulations?**

**The group should consider issues related to both manual and automated monitoring.**

**How important is monitoring and identifying unusual transactions?**

- Monitoring is essential for compliance with the law.
- The importance of monitoring systems to identify unusual transactions will depend on the type of the business a firm does.

### **What kind of monitoring is appropriate for what kind of business?**

- In a risk based environment monitoring systems will be driven by the type of business a firm does e.g. whether a firm decides to implement an active or passive approach to monitoring using staff vigilance or automated systems to ensure the monitoring adds value.

### **What are the implications of Proceeds of Crime Act 2000 (PoCA) for monitoring practices?**

- The changes PoCA has made to the UK's legislative approach to money laundering means without active or better monitoring most firms would not be able to meet their strengthened obligations e.g. to report all crimes to NCIS, to be confident that they could meet the 'reasonable' grounds test for reporting suspicions and to deal effectively with transactions that require consent form NCIS.

### **What are or may be the difficulties in having an active approach to monitoring? e.g.**

- the difficulty of managing large amounts of customer or transaction information?
  - the problem of legacy systems?
  - cost?
  - the need to maintain data protection standards?
  - the difficulty of managing customer privacy?
- An active approach to monitoring will lead to an increase in staff training and staff costs for some firms.
  - More case studies would be beneficial for firms to use to train staff.
  - A strong business case will be needed to justify the increase in costs to senior management.
  - It will be difficult for some firms to comply with.
  - The Data Protection Act may raise issues for some firms and increase costs.

## **Orange group**

**Question: Please consider the options set out in DP22, in particular to give the pros and cons of each option and explain which of the options is most preferred and give the reasons why?**

**The pros and cons of each option and explain which of the options is most preferred and give the reasons why.**

**Option 1** – to make new specific rules and/or guidance on KYC and/or monitoring (which could include a direct link to the Joint Money Laundering Steering Group (JMLSG) Guidance Notes):

- Historically, the JMLSG Guidance Notes have focused on customer identification - the Guidance Notes could be more balanced by including more guidance on obtaining and using KYC information and use of monitoring.

- It was recognised that there would be a delay in providing additional guidance on KYC and monitoring as this would have to wait until the 2004 re-write of the Guidance Notes.

**Option 2 – to make new high-level rules and/or guidance, to promote better money laundering risk management by firms**

- Firms would benefit from having a clear understanding of what an appropriate risk assessment entails, before new rules or guidance are issued.
- More information from the law enforcement agencies would be beneficial to firms understanding of where the real risks of money laundering are.
- New money laundering rules or guidance would be improved if they were comparable with prudential rules.

**Option 3 – to make no new rules or guidance; and to rely on the JMLSG Guidance Notes to promote adequate standards in regulated firms**

**Option 4 – to make no decision now and review the position again in, say, two years time.**

- Option 3 or 4 would be most appropriate because:
- There has been a significant amount of legislative change over the past 2 years - the Regulations 2003 and JMLSG Guidance Notes for 2003 have not yet been issued.
- More information from law enforcement agencies regarding the real risks of money laundering is needed.
- A defined understanding of what is an appropriate risk assessment would be helpful before new specific or high level rules or guidance are issued.
- The FSA could make the new rules and guidance and review the issue again in, say, two years time.

## **Annex 2**

Abbey  
Alliance & Leicester  
Arab Bank  
Arbuthnot Latham  
Asset Recovery Agency (ARA)  
Association of British Credit Unions (ABCUL)  
Association of British Insurers (ABI)  
Association of Chief Police Officers (ACPO)  
Association of Foreign Banks (AFB)  
Association of Friendly Societies (AFS)  
Association of Private Client Investment Managers and Stockbrokers (APCIMS)  
Aviva  
Bank of America  
Barclays  
Bear Stearns  
Britannia Building Society  
British Bankers Association (BBA)  
Bruin Dolphin  
CallCredit  
Cambridge Technology Solutions  
Clydesdale Bank  
Cube Financial Ltd  
Deloitte and Touche  
Deutsche Bank  
Egg  
Electronic Money Association (EMA)  
Equifax  
Ernst & Young  
Experian  
Fidelity Investments  
FSA Consumer Panel  
Futures and Option Association (FOA)  
GB Group  
Gerrard Limited  
HBOS  
Henderson GI  
HM Custom & Excise (HMCE)  
HM Treasury  
Home Office  
HSBC  
Investment Management Association (IMA)  
Joint Money Laundering Steering Group (JMLSG)  
KPMG  
Legal & General  
Lloyds TSB  
London Investment Banking Association (LIBA)

London School of Economics (LSE)  
Mantas  
MBNA Europe Bank  
National Consumer Council (NCC)  
National Criminal Intelligence Service (NCIS)  
Nationwide Building Society  
Net Economy  
Office of the Information Commissioner  
PricewaterhouseCoopers (PWC)  
Prudential  
Royal Bank of Scotland (RBS)  
RSM Robson Rhodes  
Searchspace  
Semagix  
The City of London Police  
The Metropolitan Police Service  
West LB  
Yorkshire Building Society