

As the FSA's Sector Leader for Financial Crime, I am pleased to introduce our first quarterly Financial Crime Sector newsletter. Its purpose is to help our external stakeholders track recent and prospective developments in our financial crime work and thinking. We plan to keep the news items short, but include references where fuller information can be found (often on our web site).

In our first edition we cover:

- an introduction to the role in the FSA of the financial crime sector;
- our recent financial crime conference;
- the launch of our new fraud policy;
- our thematic review of information security;
- our work on 'defusing the ID issue';
- our clarification of our supervisory approach and in particular our enforcement policy with regard to anti-money laundering; and
- our work on the Third EU Money Laundering Directive.

I hope you find this newsletter useful. We would welcome feedback and ideas for future issues.



Philip Robinson

## Financial Crime Sector Leader

The FSA introduced the new concept of Sector Leader when we restructured in April this year. A number of our Managing Directors and Directors now have not

only line responsibilities but cross-FSA sectoral responsibilities. There are five industry sectors: banking, capital markets, asset management, retail intermediaries and insurance, and three cross-industry sectors: financial stability, consumers and financial crime.

The Sector Leader role is challenging. It is to:

- help the FSA become better at spotting risks early on and taking pre-emptive action to manage issues swiftly and decisively;
- build and maintain strong relationships with external stakeholders to help make it easier for them to do business with us;
- ensure that issues are considered on a cross-FSA basis so that we achieve our objectives and priorities in the most efficient way possible; and
- develop the skills and knowledge of our staff.

*'The sector leaders and their teams are out and about in the marketplace; keeping their ear to the ground; picking up intelligence; and ensuring that we, as an organisation, are focussing on the right things. They are also working to develop our people's technical capabilities.'* John Tiner

My Sector Leader position demonstrates that fighting financial crime matters at the FSA – the reduction of financial crime is after all one of our four statutory objectives. This objective supports, and is supported by, our other objectives – the protection of consumers, maintaining market confidence, and raising public awareness.

**Our regulatory objective is quite simply to deter criminals and terrorists from trying to use the financial system to perpetrate**

financial crime; and to make it easier to catch and punish those who do use it.

## FSA Financial Crime Conference

Over 300 delegates from the industry, regulation, law enforcement, trade bodies and other stakeholders attended the FSA's Financial Crime Conference on 'Fraud and Money Laundering: Managing the risks in partnership', on 26 October 2004 in London.

Leigh Lewis, Permanent Secretary, Crime, Policing, Counter Terrorism and Delivery at the Home Office, set the tone for the day in his opening address when he said:

*'We need to work together with the industry, with the regulators, with the public and others, to help each other and that has been key to many of our recent initiatives.'*

*Tell us in Government about the barriers that you see and you think we have erected, wittingly or unwittingly, which are making it more difficult for you to combat financial crime.'*

Philip Robinson launched the FSA's new fraud policy – 'Fighting Fraud in Partnership'. The policy (see page 3 below) is based on the need for a collective effort to improve the fight against fraud in the financial services sector and for the FSA to make a distinctive and important contribution to that effort.

Presentations were given by Detective Chief Superintendent Ken Farrow (Chairman of the Association of Chief Police Officers (ACPO) National Working Group on Fraud), Ros Wright (Chairman of the Fraud Advisory Panel) and Bill Hughes (Director General Designate of the proposed Serious Organised Crime Agency (SOCA)). A panel of industry representatives discussed the industry's role in fighting fraud.

In the afternoon the focus turned to anti-money laundering. Stephen Timms MP (Financial Secretary to the Treasury) launched the joint Treasury/Home Office/Foreign and Commonwealth Office Anti-Money Laundering Strategy, prepared in consultation with other government departments and agencies, the FSA, the industry and other stakeholders. Mr Timms referred to the three principles underpinning the

strategy – effectiveness, proportionality and engagement. He too stressed the need for co-operation:

*'Working together and shared ownership are important themes of our vision for how this regime should work.'*

Ian Mullen, Chief Executive of the British Bankers' Association (BBA) and Chairman of the Joint Money Laundering Steering Group (JMLSG), spoke in particular about the revision of the JMLSG Guidance Notes, the work on ID, and the EU Third Money Laundering Directive. Bob Ferguson (Head of Policy and Intelligence at the FSA) spoke about our new more targeted approaches. A panel of stakeholders discussed the issue of identification.

A full transcript of the conference will be available on the FSA's website ([www.fsa.gov.uk](http://www.fsa.gov.uk)).

## Financial crime objective (Financial Services and Markets Act [FSMA] s.6)

Our reduction of financial crime objective is 'reducing the extent to which it is possible for a [regulated firm] to be used for a purpose connected with financial crime.'

Financial crime has a very broad scope, covering:

- fraud/market misconduct/money laundering/and other e.g. corruption; and
- firms both inside and outside the perimeter (unregulated).

FSMA s.6 also tells us to focus in particular on firms' financial crime risk management - we are required to have regard in particular to the desirability of:

- (a) regulated persons being **aware of the risk** of their business being used in connection with financial crime;
- (b) regulated persons **taking appropriate measures** (in relation to their **administration and employment practices**, the **conduct of transactions** by them and otherwise) to **prevent** financial crime, **facilitate its detection** and **monitor** its incidence; and
- (c) regulated persons devoting **adequate resources** to the matters mentioned in paragraph (b). (FSMA s 6(2))

## We also have other powers/duties

- to prosecute breaches of the Money Laundering Regulations;
- to co-operate with others on the prevention and detection of financial crime (FSMA s354); and
- to make suspicious activity reports to the National Criminal Intelligence Service (NCIS).

## 'Fighting Fraud in Partnership' – new policy on fraud by the Financial Services Authority

We have been reviewing our approach to tackling fraud in the financial services sector. Last December we published our Discussion Paper 26 – 'Developing Our Policy on Fraud and Dishonesty' – and at our conference on 26 October we launched our new policy – 'Fighting Fraud in Partnership'.

The FSA called on all involved in the fight against fraud in the financial services industry – firms, trade associations, the FSA, Government, the police, and others – to work together to make life more difficult for the criminal.

Philip Robinson, said:

*'The time is right for us all to raise our game and to join together to fight fraud in partnership.'*

Within the next couple of years the FSA aims to see significant progress towards better fraud defences. Including:

- the sector as a whole working smarter and harder to fight fraud;
- the trade associations working together closely, providing leadership over fraud management (as they do already over money laundering);
- a clear lead from the top of financial organisations – that fraud is a significant threat that needs managing strategically and effectively;
- a clearer picture of the risks and scale of fraud and the best ways of tackling it; and
- a culture where firms are more confident in sharing information on significant frauds and near misses and do so as a matter of course for the benefit of the industry as a whole.

The conference speech is available at:

<http://www.fsa.gov.uk/pubs/speeches/sp208.html>

## UK Financial Crime Statistics

### Fraud against the private sector:

- In 1999, this cost firms £1.5bn per year – equivalent to £25 for every adult and child in Britain.  
[Source: National Economic Research Association Study for the Home Office]

### Fraud against the financial sector:

- By 2004 the financial services sector is now losing some £11bn per year from economic crime (fraud, money laundering etc).  
[Source: RSMI Robson Rhodes Economic Crime Survey 2004]

### Plastic card fraud:

- Losses of £479mn in 2003-04, up from £97mn in 1994. Almost a 500% increase over ten years.
- Total card fraud rose by 18% in the 12 months to June 2004.
- There is a fraudulent transaction every eight seconds.  
[Source: Association for Payment Clearing Services (APACS)]

### Insurance:

- 3.7% of all insurance premiums result from fraud losses.
- Fraudulent motor and household claims cost £20mn per week.  
[Source: Association of British Insurers (ABI)]

## FSA calls for improved information security in the fight against fraud

A report we published on 11 November – 'Countering Financial Crime Risks in Information Security' – paints a mixed picture of how financial firms are managing their information security in the fight against fraud and other financial crime. The report, which reviewed 18 firms, is part of our new approach to fighting fraud in the financial services industry. Whilst some major

firms have built their defences after being targeted by hackers and fraudsters, small and medium-sized firms are less well prepared.

The report highlights the need for senior management to take on responsibility for information security. It emphasises the need for firms continuously to review and update their defences to keep on top of the increasingly sophisticated methods used by criminals.

The report found that traditional threats to information security still existed in some firms because they had not invested adequately in their security frameworks. Some did not properly control employee access rights or user administration in their networks. Legacy systems with poor security design were also identified as a common threat.

However, others had responded to the emergence of new information security threats, such as 'phishing'. These new threats have served to remind firms of the need to secure their – and their customers' – assets from both internal and external threats e.g. by privileged account monitoring and IDS/IPS software. The report identified security awareness campaigns as an effective defence strategy being used by firms.

Other information security threats identified in the report include new technologies such as instant messaging, Personal Digital Assistants, USB pens and Smart phones. The latter three devices can be used to steal corporate information or act as sources of virus infection.

The report notes that, so far, few firms have built relations with the various industry bodies and government agencies which are working to reduce such crimes. We give the website addresses for many of these bodies in the report.

The report is available at:

[http://www.fsa.gov.uk/pubs/other/fcrime\\_sector.pdf](http://www.fsa.gov.uk/pubs/other/fcrime_sector.pdf)

## 'Defusing the ID issue'

On 14 October we published a progress report ('ID – defusing the issue: a progress report') on the work we have been leading to achieve a customer identification (ID) regime that is more economical for firms, commands stronger buy-in from customers and helps the fight against crime and

terrorism. The report reflects the discussions of our ID working group, which had representatives from all the major stakeholders including the industry, law enforcement, consumer organisations, government, credit reference agencies and others.

Discussions in the working group showed a common commitment to achieve an ID regime that is effective and that all stakeholders can support. All agreed that there are ways to streamline the regime without reducing its effectiveness.

One objective of the work was to produce input into the current radical revision of its Guidance Notes by the Joint Money Laundering Steering Group (JMLSG). Key propositions offered to the JMLSG include:

- there is scope for increased reliance on a single document (such as a passport or driving licence) to establish identity;
- electronic verification methods can be cheaper and more effective than document-based methods;
- greater reliance on ID done by other firms would reduce duplication; and
- a more tailored approach is needed for non-personal customers and wholesale business.

The JMLSG expect to issue revised Guidance Notes in draft early in 2005.

Other key messages from the working group included the need for:

- the FSA to address the so-called 'fear factor' (see below);
- ID to be done in a customer-friendly way, so that customers see the identification process as a sensible contribution to the fight against crime and terrorism and not as a burdensome barrier to access to financial services;
- government and the industry to communicate the reasons for ID and what it involves; and
- the government's work on improving the integrity of official documents such as passports.

The report is available at:

[http://www.fsa.gov.uk/pubs/other/id\\_report.pdf](http://www.fsa.gov.uk/pubs/other/id_report.pdf)

## Our supervisory approach to anti-money-laundering

As part of our work on ID, we are committed to tackling the so-called 'fear factor' – that is, the representations to us that firms adopt unduly conservative ID practices, and are inhibited in pursuing a risk-based approach, for fear of regulatory sanctions. In response to these representations, Philip Robinson clarified our anti-money laundering (AML) supervisory approach and enforcement policy in a letter of 25 October to Ian Mullen, Chairman of the JMLSG.

The letter notes that our supervisory and enforcement action since N2 (1 December 2001, when the FSA gained its powers under the Financial Services and Markets Act) has been effective in raising industry AML standards, in particular for ID and record keeping. It says that we will still consider using our enforcement tools in these types of cases where there are particularly aggravating circumstances, but going forward we will increasingly focus on other aspects of money laundering controls.

In deciding whether to take enforcement action, we will consider in particular cases where:

- money laundering risk is high and firms fail to take appropriate action to introduce mitigating controls; or
- firms introduce controls but fail to ensure that they are implemented effectively.

We will look not just at breaches of the Money Laundering Sourcebook, but at failures in wider systems and controls, and whether these failures have contributed to or facilitated actual money laundering. Even in cases where money laundering has taken place or been facilitated, we will not necessarily take enforcement action. Enforcement action is more likely when we see that a firm has not taken adequate steps to identify its money laundering risks, not put in appropriate controls to mitigate those risks, and failed to take steps to ensure controls are being effectively implemented.

In reality only a small proportion of firms with weak AML controls are subject to enforcement action. More commonly weaknesses are dealt with through informal discussions with supervisors, remedial action plans through the ARROW

framework, or in some cases by issuing private warnings. Only where there is a significant failure in systems and controls do we consider taking public enforcement action.

We also recognise that any regime that is risk-based cannot be a zero failure regime. The new JMLSG Guidance Notes will provide the basis of our training of our supervisors about the risk-based approach.

We believe that a better understanding that our approach to failures in AML controls will not automatically involve disciplinary sanctions should remove any 'fear factor'. And it will encourage senior management to implement an effective risk-based regime.

The full text of the letter is available at:

[http://www.fsa.gov.uk/pubs/other/money\\_laundering/jmslg.pdf](http://www.fsa.gov.uk/pubs/other/money_laundering/jmslg.pdf)

## The Third EU Money Laundering Directive

Negotiations on the EU Third Money Laundering Directive have proceeded apace. We – and other stakeholders – have been working closely with the Treasury to help secure a satisfactory outcome. After rapid progress in a Council Working Group under the Dutch Presidency, political agreement could well be reached at ECOFIN - the Council of Finance Ministers - in December. Discussion of a revised draft has already started in the European Parliament. The nature and timetable for the remaining processes depend on how comfortable the Parliament is with the proposal. The directive could well be adopted by mid-2005.

A main aim of the directive is to implement the revised Financial Action Task Force on Money Laundering (FATF) Recommendations issued in 2003. To that extent many of the changes to the existing EU regime are predictable. But they will in due course be implemented in UK law through Treasury regulations. So the industry will need to continue to look carefully at the emerging text to see what will become UK law on such topics as the definition of beneficial owner and enhanced due diligence in the case of non-face-to-face business, Politically Exposed Persons (PEPs) and correspondent banks.

---

## Contact details

We intend to issue this newsletter quarterly. If you would like to receive this newsletter in future or have any comments on its content or format please contact us by e-mail at:  
**financial.crime@fsa.gov.uk**

Individual contact details are as follows:

Martin Owen (Financial Crime Sector Manager;  
Head, Financial Crime Policy Unit)  
**martin.owen@fsa.gov.uk**  
020 7066 0780

Gillian Mackenzie  
(Financial Crime Sector Associate)  
**gillian.mackenzie@fsa.gov.uk**  
020 7066 0662

Chris Eridani-Ball (Fraud Policy)  
**chris.eridani-ball@fsa.gov.uk**  
020 7066 3490

Ian Matthews (Fraud Policy)  
**ian.matthews@fsa.gov.uk**  
020 7066 1092

Joy Alderton (Information Security)  
**joy.alderton@fsa.gov.uk**  
020 7066 0520

Jamil Choudhry (Anti-Money Laundering Policy)  
**jamil.choudhry@fsa.gov.uk**  
020 7066 1936

Helen Smith  
(Anti-Money Laundering Policy & Newsletter)  
**helen.smith@fsa.gov.uk**  
020 7066 0656