



Financial Services Authority

***ID - defusing the issue:
A progress report***

**Financial Crime Sector
Report**

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Foreword

In my speech of 21 April (*Anti-money laundering regulation – next generation developments* - see extract at Annex A), I explained why customer identification (ID) is seen as a problem - for firms and their customers. I issued a challenge to the various stakeholders to work together with us so that, by the end of 2005, we have collectively defused the ID issue and effectively managed customer expectations and the customer experience. To this end, we would bring together a broadly-based group to consider the challenge and to propose any solutions in time for the Joint Money Laundering Steering Group (JMLSG) revision of their Guidance Notes.

A working group with members from a wide range of stakeholder organisations (see Annex B) has met four times since May. The working group was not a decision-making body. Its purpose was to build a stronger common awareness of the issues and options, and of stakeholders' different perspectives, amongst all the stakeholders. All the stakeholders have found this extremely useful.

This note is a progress report by the FSA to inform the industry and other stakeholders of current thinking and activity on ID. A great deal of work has been, and is being, done. We propose to reconvene the working group early in 2005 to take stock of progress made.

As the report notes, ID is an apparently simple process, but it is done in a complex context, which has changed significantly in recent years (for example, the development of electronic verification tools and the increase in non-face-to-face business). ID is a legal requirement, an important control for firms and a valuable tool for law enforcement. It therefore raises important issues. We should be prepared to change existing practices when justified. But we should not change them lightly. We therefore thought it would be helpful to readers to include in this progress report some of the thinking behind possible changes in how ID is done in the UK.

There is a common will to evolve the present regime to one that is more readily recognised to deliver value at reasonable cost and to engage the full-hearted support of the industry and its customers. Some of this evolution will involve changes in how ID is done. Some will involve improving stakeholder understanding. All stakeholders have a role to play.



Philip Robinson – Financial Crime sector Leader



1. Executive Summary

1. The FSA is working with other stakeholders in seeking to 'defuse the ID issue'.
2. ID is a core anti-money laundering (AML) and legal obligation. It contributes to the fight against crime and meets other business needs of financial institutions. It is a straightforward concept, but how ID should be done raises difficult issues - because of the diversity of circumstances, and the number of cases, in which it has to be done.
3. ID is an issue because of concerns about:
 - **the customer experience:** there is some evidence of customer dissatisfaction, but also that consumers accept the need for ID and how it is done;
 - **cost and value:** in the absence of a national ID token, ID may attract an undue proportion of spend on AML without commensurate benefit;
 - **a 'fear factor':** how ID is done may be unduly influenced by perceptions of FSA supervisory and enforcement policies.
4. The key messages emerging from stakeholder discussions are:
 - ID is an important tool for fighting money laundering and crime, and meets other important business needs;
 - ID is but one AML tool, and needs to play a proportionate role alongside other AML tools;
 - electronic verification is a valid approach to ID, and has advantages over documentary verification;
 - customer understanding of the reasons for ID is important;
 - an effective approach to ID by firms is important;
 - the data captured in ID have important law enforcement value;
 - ID should be done on a risk-based basis;
 - perceptions of the FSA's supervisory and enforcement approach are important.
5. Much relevant work is in progress:
 - to revise the JMLSG Guidance Notes - the JMLSG is looking in particular at:
 - allowing for greater reliance on a single document;
 - encouraging the use of electronic verification;
 - promoting greater acceptance by one firm of ID done by another;
 - developing a more tailored approach for non-personal customers;
 - to improve communication of the reasons for ID;
 - to strengthen the integrity of official ID tokens;
 - to clarify the FSA's supervisory and enforcement approaches.
6. We will review progress, with other stakeholders, early in 2005.



2. The Context

1. ID is an apparently simple process, but it has to be applied in a complex context. (By 'ID' we mean establishing that the customer (personal or non-personal) is a particular person or entity. It does not include 'Know Your Customer' - the process of obtaining the customer's sources of income, income and expenditure patterns or other information that may help the firm to manage its continuing financial crime risks).

ID is a core control

2. ID is, and has long been, an internationally recognised key anti-money laundering (AML) control. It is also required by law and by regulatory rule. We have taken that as a given and not debated the principle of ID. The issue is not *whether* it is done, but rather *how* it is done.

ID is a common practice

3. ID is not just a financial sector practice - it is pervasive in modern society. For example, it is used to prevent fraud by mobile phone companies, video rental stores, and retail stores issuing store-cards. The drinks industry asks young customers for ID to check that they are not under-age. Under the Money Laundering Regulations 2003, a range of non-financial sectors (e.g. solicitors, accountants, casinos, estate agents) is now required to do ID.

ID contributes to the fight against crime

4. ID is an AML control. Money laundering converts the proceeds of crime into assets that appear to have a legitimate origin, so that they can be retained for personal benefit or used to finance further crime. So, AML controls, including ID, are not for abstract, obscure purposes or simply about financial crime – they are integral to the fight against drugs, people-trafficking, theft, fraud, tax evasion and other real world social evils. This is in the wider public interest and important to every law-abiding member of the public.
5. For customers, ID can help protect them against the growing risks of identity theft or fraud.

ID has non-AML value too

6. Financial institutions use ID for other purposes, often at the same time as they do ID for AML purposes. This influences the practice of ID. It helps them:
 - protect themselves - and their customers and third parties - against fraud, including ID fraud;
 - manage their credit risk – that is, reduce the likelihood that they will lend money or assets to a customer who will be unable to pay them back; and
 - manage their customer relations generally and develop their business.



The UK has no official ID token

7. Unlike many other countries, the UK has had to develop ID practices in the absence of any universally held official token with basic ID information. The Government is developing legislation for a national ID card system, but it will be some years before any system is generally rolled out.

ID is a high volume activity

8. The need to access the services of the financial services sector is very much a part of modern life. This need will increase as the Government shifts welfare benefits directly into accounts rather than making cash available through benefit books or cashable cheques. Moreover, public policy seeks to maximise access to the financial system because of the advantages it can bring to individuals in managing their personal needs efficiently and economically (e.g. fuel discounts for payment by direct debit).
9. So, the financial services sector has many millions of customers. According to BBA statistics there are approximately 120 million current and deposit sterling accounts in the UK. And every year millions of individuals and entities become new customers of banks, building societies, insurance companies, fund managers, IFAs, investment brokers and other financial businesses - by opening new accounts, taking out new products or changing financial services provider.

ID is not just done at the counter

10. Much ID is done directly with customers in a branch by banks, building societies and other branch businesses. In these cases, customers can be asked to bring in documents that verify their identity. But, increasingly, new personal customers are taken on a 'non-face-to-face' basis - on the telephone, through the internet or by post. And in the wholesale sector, accounts for non-personal customers are usually opened on a 'non-face-to-face' basis as well.

ID is not just about individuals

11. ID is often seen as an issue in relation to individuals, as personal customers. But it is also an issue for non-personal customers (and counterparties), such as companies, trusts, foundations, funds and other entities. Just as personal customers may launder money, so may non-personal customers. In these non-personal cases, problems arise both in verifying the identity of the legal entity and in conducting ID checks on the individuals who are directors, trustees, beneficial owners, controllers etc. of the entity.

A challenging matter

12. In this complex context, it is not surprising that the practice of ID raises issues, that stakeholders have different perspectives, or that defining the ingredients of a satisfactory regime is difficult.



3. The Issue

13. The 'ID issue' comprises a number of strands, on which different stakeholders have different perspectives. The main strands concern:
- the customer experience;
 - cost and value for money;
 - the FSA's supervisory approach.

The customer experience

14. There is a range of indications of dissatisfaction on the part of individual customers or would-be customers - letters to MPs, the Government and the FSA; media reportage; views expressed by industry sectors; concerns expressed by those representing customers unable to provide standard tokens of ID; and anecdotal social discourse.
15. In the wholesale and institutional markets, there are concerns that the UK regime is deterring non-personal customers from becoming customers in the UK of UK-based firms.
16. At the same time, the complaints received by the big UK retail banks from individuals (including complaints triggered by their current work to verify existing customers) are very low relative to the number of their customers. In the banks' perspective, most individuals now understand the need for firms to do ID, take ID for granted and can readily satisfy firms' standard ID requirements. Instead, the banks see the issue as primarily about individuals who cannot produce the standard ID tokens. With these in mind, the JMLSG Guidance Notes have over time significantly broadened the range of documents that may be used to verify ID. As a result, the ID regime has become more complex and in some respects more difficult to apply on the ground. However, the banks have opened over 800,000 basic bank accounts (that is, accounts limited to payments in, and withdrawals by, the account holder) since April 2003.
17. In order to shed more systematic light on customer attitudes to ID, we recently commissioned an independent survey of customer attitudes to and experience of ID. We will be publishing the results of this shortly. It shows generally very positive attitudes on the part of individuals. For example, a large proportion of respondents thought it was straightforward to prove their identity and did not have a problem with being asked. Younger respondents were significantly more supportive than older ones.

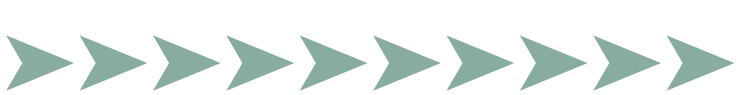


Cost and value for money

18. The industry has expressed strong concerns about the increased costs of AML and questioned whether their investment gives value for money. The BBA's 2003 survey on the FSA's Regulatory Framework identified AML as one of the biggest drivers of increased compliance costs. Firms questioned whether this was leading to a competitive disadvantage for UK firms and a cost that bore little relation to the benefit achieved.

The FSA's supervisory approach

19. Firms often say that our supervisory approach and enforcement actions cause them to take a very conservative approach to ID in order to reduce the likelihood of regulatory sanctions. This is sometimes referred to as the 'fear factor'.



4. Defusing the issue

20. We believe we will collectively defuse the ID issue if:
- ID contributes to an effective AML regime that reduces the likelihood of the financial system being used for money laundering, fraud and terrorist financing;
 - ID delivers value to law enforcement;
 - customers (including those who do not have standard ID tokens) recognise the value of ID for AML and other purposes, know what it involves, and believe that it is being applied reasonably and sensibly for these purposes;
 - the industry believes that ID for AML purposes gives value and that what is expected of them is clear, proportionate and sensible; and
 - regulatory expectations are well understood, promote sensible, proportionate good practice, and do not induce a 'fear factor'.
21. A fuller statement of the stakeholder needs identified by the working group is at Annex C.



5. Key Messages

22. To a certain extent, discussions in the working group affirmed established thinking and practice. But, in other respects, they indicated an appetite for evolutionary change. The **key messages** that have emerged from the working group discussions are summarised below.

i. ID is important

23. ID is an important tool in the fight against money laundering control, financial crime and other crime. It:

- helps deter use of the financial system for the purposes of financing crime, terrorism and the laundering of criminal proceeds;
- makes use of the financial system for those purposes more risky;
- provides useful intelligence to law enforcement;
- also helps firms manage credit, fraud (including ID fraud) and other business risks; and
- contributes to a firm's commercial effectiveness.

ii. ID is but one AML tool

24. But ID is only one AML tool. It needs to bear proportionate weight - and cost - in the overall AML control environment. There is a risk that ID is given undue weight simply because it has a universal application and is done at the outset of the customer relationship. However, an effective AML programme also requires:

- a risk management framework, providing the basis for applying AML controls according to a risk-based approach;
- know your customer procedures (obtaining information about the reason for opening an account, source of income, expected use of account etc);
- monitoring (electronic or otherwise) customer transactions;
- an efficient internal and external reporting system; and
- good staff training, record-keeping and other support operations.

25. A proportionate approach to ID is all the more important given the increased cost of AML, attributable to, for example, the development of monitoring and the more demanding suspicious activity reporting regime.

iii. Electronic verification is a valid approach to ID

26. Historically, ID has relied on the customer providing documents. In the case of personal customers, these are passports, driving and other licences, utility bills, letters from care home managers etc. This documentary approach will continue for some customers. However, the industry now makes increasing use of 'electronic verification', particularly



for UK-based personal customers. This involves confirming identity - either alone or in conjunction with documentary methods - via a credit reference agency (CRA) (or one of the non-CRA service providers that are now also entering the market).

27. Electronic delivery does not in itself make verification more robust. But electronic verification can have significant advantages:
- for firms, it can be a straightforward way of accessing several corroborative sources (because CRAs draw on multiple data sources, including individuals' credit history);
 - customers do not need to provide documents, unless the firm considers that further corroboration is required in the circumstances;
 - record-keeping is easier and cheaper;
 - in non-face-to-face business it reduces the need for customers to send important personal documents by post, with risk of loss and inconvenience;
 - it can be cheaper than obtaining paper documents;
 - it can be delivered in the broader context of other related checks (e.g. checks against terrorist sanctions lists or credit history checks).
28. Electronic verification is already recognised in the JMLSG Guidance Notes. But there has been some hesitation about the electronic option because of concerns about its effectiveness and uncertainty about its compliance with legal and regulatory obligations. Also, current practices in the use of electronic verification vary.
29. There is, however, general agreement that electronic verification is a valid approach to ID, and indeed that in many cases it is likely to have greater authority and be more convenient for both firm and customer than using paper documents. However, it is also recognised that there is a need for greater guidance to firms about how they should use it.
- iv. Customer understanding is important**
30. As a result of ID requirements, every year many personal and non-personal customers are asked to confirm their ID in the course of becoming a new customer of a firm. It is important that they should see this as a sensible contribution to the fight against crime and terrorism, in their interests, and not as an unnecessary or unduly burdensome imposition. It is also important that they should not see it as a barrier to financial services. At the same time, customers also need to recognise that adequate ID does not create an entitlement to an account. It is for firms to decide which customers they take on and based on their own procedures which are additional to and often separate from the basic AML requirements.
31. To contribute to this understanding and support, ID needs to be done in as proportionate, 'customer-friendly' a way as possible. Firms' procedures and staff training need to be designed and operated accordingly.
32. There also needs to be effective communication of the reasons for ID and what it normally involves. There has been some progress in recent years. Increasingly, firms include material on the reasons for ID in their own application packs. In July 2003, the Treasury, NCIS and the FSA issued a joint standard customer leaflet designed to promote customer awareness of -



support for - the reasons for ID. This was developed in close cooperation with the industry. In May 2004, we issued a fact sheet on ID (*Checking your identity – the fight against money laundering, financial crime and terrorism*). And in May 2003, we published a leaflet on basic bank accounts, (*No bank account? Why it could pay you to have one*). These include an explanation of the reasons for ID and how customers can meet these needs.

33. The industry believes strongly that this communications activity – and the public interest message - needs to be reinforced by more visible Government support.

v. Effectiveness is important

34. Whatever the ID regime, ID needs to be done well:

- thoughtfully (e.g. checking that an individual is not of a conspicuously different gender, ethnic group or age to the person in a photograph in an identity document);
- accurately (e.g. recording correctly dates of birth, name spellings, addresses);
- competently (e.g. applying set procedures in practice); and
- usefully (e.g. ensuring that photocopies are legible).

This applies in the case of both personal and non-personal customers

vi. Data are important

35. ID involves obtaining identity information from a customer and verifying that information, as necessary, in order to enable the firm to be reasonably satisfied, as required by the law, that the customer is who they claim to be (and to meet the firm's own business needs). Through ID, firms obtain and retain data that are of value to law enforcement - they can be used at a later date, to help in the investigation and prosecution of crime or terrorism and in the freezing or confiscation of the proceeds of crime. Even if the data recorded come from a forged document they will still be of use to law enforcement investigations, if properly recorded.
36. So, data accuracy, storage and ready accessibility are important to law enforcement.
37. Law enforcement agencies have indicated that the data items of particular investigative value to them are:

- for individuals - (not in any priority order) name, current address, date of birth, nationality, national insurance number and reference data derived from identification documents e.g. passport numbers.

So far as address is concerned, current address - rather than address at the time of ID - is the starting point for law enforcement enquiries.

In the case of individuals, law enforcement also attaches high value to a photograph (with a strong preference for it being in scanned form, since photocopies of, for example, a passport photograph are often too poor to be of value).

- for non-individuals - (again, not in any priority order) entity name, registration number or similar official identifier, address of registered office, correspondence address, and the names of key individuals (especially those in a position to control entities or to initiate transactions).



38. Predictable and consistent information would also help law enforcement efficiency and effectiveness. But it is also important to industry that law enforcement agencies have realistic and proportionate expectations of the information likely to be available to them.
39. The fact that law enforcement has 'needs' does not mean that meeting them should become a matter of regulatory obligation or universal practice. Nor do these needs have to be met only through the ID process. In many cases, firms will collect relevant data (for example current address or name) for their own commercial and risk management purposes. Better understanding of the needs of law enforcement will, however, enable firms to consider factoring those needs into their policies and practices on data acquisition, storage and management.

vii. ID should be risk-based

40. Subject to limited exceptions, the law requires a firm to obtain satisfactory evidence of identity whenever it takes on a new customer. However, the law does not stipulate the detail of what this should involve. It defines 'satisfactory evidence' as 'evidence which is reasonably capable of establishing (and does in fact establish to the satisfaction of the person who obtains it) that the applicant for business is the person he claims to be'. This puts the onus on the firm to be satisfied, given all the information available to it. So, the law sets a minimum standard, but it gives scope to firms to verify identity to a depth that varies according to the risk characteristics of the customer, product/service and other circumstances. This need not be done on an individual case by case basis (this would be impractical for firms taking on large numbers of customers). The firm can do it on a generic basis – by reference to type of customer and other circumstances.

viii. The FSA's approach is important

41. Regulated firms must comply with regulatory requirements on AML. However, these are for the most part, and will remain, high level. They allow firms to take a risk management, risk-based approach. They give, and will continue to give weight to the Guidance Notes, but do not treat them as prescriptive obligations. They do not emphasise ID specifically.
42. A number of factors suggest that our regulatory approach is reasonably balanced - the results of our risk assessments of individual firms (only a minority of firms attract High or Medium High AML risk ratings), the terms of our thematic work (published on the Money Laundering Information section of our web site), and the small number of cases (six) in which enforcement action has been taken over a three year period.
43. However, we recognise that, however well-founded, there is an industry perception that we concentrate on ID and other processes, rather than AML risk management; that we treat the Guidance Notes as rules rather than guidance; and expectations are at a high risk of well-published sanctions.
44. Firms also express concern that, if they follow a risk-based approach, we will challenge their judgements on the basis of hindsight. They fear that a firm will be sanctioned for what turns out subsequently to have been a mis-judgement of risk, even if the original judgement was reasonable when it was made.



6. Work in progress

45. The working group noted that considerable relevant work is in progress or planned by individual stakeholders. This will make a major contribution to defusing the ID issue. In the remainder of this progress report we summarise the work in progress and share some of the thinking behind emerging likely changes in the current regime.
46. Change can be expensive and disruptive in the short term, even if it involves an apparent reduction in process requirements in the long term. Change will need to be planned and done on a cost-effective basis, with adequate lead-times, transitional arrangements etc.

Revised JMLSG Guidance Notes

47. As part of a major revision of its Guidance Notes since the latter part of 2003, the JMLSG has been revising its guidance on ID. It aims to publish a full draft for consultation by the end of 2004, with a view to the revision being agreed by mid-2005 and coming into force on a practical timetable after that. The terms of the consultation draft, and of the eventual final version, will be determined by the JMLSG.
48. In developing its consultation draft, the JMLSG has indicated that it is looking at a number of ID issues.
 - i. **The scope for greater reliance on a single document to confirm ID**
49. Historically, ID has been based on customers providing documents. With the increased use of electronic verification, this is changing, but the option of paper documents is likely always to remain necessary. In the absence of a single UK official identity document, present practice for documentary ID is based on the proposition that identification needs to be 'cumulative'. That is, no single document or source of data is regarded as sufficient to verify a person's identity, and name and address should be verified separately. Under this approach, ID is satisfied in the routine, face-to-face personal customer cases by the customer providing both a passport or driving licence to verify name, and a utility (gas, electricity, water, telephone) or council tax bill to verify address. Increasingly, the Guidance Notes have given a range of other documents as possible alternatives for customers unable to provide the standard documents (e.g. benefit books, correspondence from government agencies, and written references from suitable persons).
50. In the Working Group, it was suggested that:
 - utility bills are already amongst the easier documents to forge, and their value for ID will diminish as the use of electronic billing increases, and customers print out their own;
 - the rate that people change addresses means that the address given at the time of verification rapidly diminishes in value as information;



- large numbers of customers do not receive a utility bill in their own name and current address, or have not yet received one at the time of ID (e.g. because they are new students, new arrivals in the UK, or have changed address or name);
 - in other jurisdictions, customers simply provide a single official national or local identity token;
 - the provision of a second document gives limited added corroborative value;
 - the greater the documentation required, the greater the cost of the process (e.g. data capture and retention, photocopying), and the greater the burden on customers;
 - law enforcement has more interest in current than in historic address;
 - address is often confirmed through postal communication in the ordinary course of business, after the firm has taken the customer on.
51. These points suggest the need for one of two responses: *either* major investment and change (including by e.g. utility companies) to make documentary corroboration of address more authoritative and straightforward, *or* a reconsideration of current practice to reflect factual realities.
52. The JMLSG has said that it is looking at the scope for significantly increased reliance for AML purposes on a single document - typically either a passport (including a foreign passport in the case of migrants, workers, students etc. from abroad) or a driving licence.
53. Over 85% of UK citizens over 17 have a UK passport. 41 million driving licences are in issue (20m photo, 21m non photo). 93% of the adult population in the UK has a passport or driving licence. So a high proportion of new customers should have no difficulty providing a passport or driving license. Passports and many driving licences currently both contain a photograph and date of birth, but passports do not show address. A single document approach on its own would in effect give firms the option of checking ID in the case of most customers by reference to photograph, and/or address and/or date of birth.
54. Many of those who do not have a passport or driving licence will nevertheless still be capable of electronic verification through their credit and personal history. However, that still leaves many potential customers who may not be in that position. A significant proportion of these are likely to be the poor, the disabled, those in care homes or sheltered accommodation, asylum seekers and refugees. The Guidance Notes already provide significant flexibility for these groups. For example, in the case of basic bank accounts, the Guidance Notes provide for ID to be satisfied by the personalised letter issued to the customer by the relevant benefits agency, together with the customer's existing order book or girocheque. Nevertheless, there remains a perception that firms use ID as an excuse for not taking a member of such groups on as a customer. That aside, identification in these cases can be burdensome for the firms (e.g. operating an individualised process and, possibly, providing an internal Help Desk). It can also be problematic for the customer.



55. The logic of the single document approach would be for the official letter of offer from the relevant benefit agency, or some analogous letter from a government agency, to be more generally acceptable as the means of satisfying ID. The JMLSG is considering this option where such a letter contains relevant data on the individual concerned and is issued subject to adequate controls. This would also help to achieve a more standardised and predictable approach.

ii. How firms should use electronic verification services methods

56. The JMLSG is discussing with the industry and CRAs the factors which firms should consider when developing electronic verification policies and practices and in selecting service providers.

iii. The scope for greater reliance by firms on ID done by other firms

57. The legal and regulatory obligations to do ID checks apply to every firm. This means that a firm must do ID even if another regulated firm (including one in the same group) has done ID for the same person.

58. The law, and our rules, allow firms to delegate the task of doing ID to another firm. However, the delegating firm cannot give up responsibility for the performance of the ID. Historically, there have been 'introduction certificate' arrangements between product providers (e.g. life offices and unit trust managers) and IFAs, where IFAs provide the product provider with details and copies of the results of their ID and the product provider treats that as meeting its responsibility. These arrangements were revised in 2003, but their use remains patchy. Product providers have been concerned about the risk of liability if it turns out that an intermediary has not applied adequate ID standards. Providers have also been cautious about which intermediary firms they are prepared to rely on. There is no industry standard for the information that intermediaries must provide.

59. More radically, firms that are not banks argue that they should not have to do ID at all in those cases - the great majority - where a bank has already carried out ID on the new customer or funds are remitted from an existing bank account. Understandably banks for their part do not want to bear all the burden of the cost of ID and fear increased risk of liability.

60. These issues are not straightforward. However, there is a recognition that more extensive 'reliance' in the industry, through more widespread delegation, could bring significant cost benefits to the industry as a whole. This includes banks (which take customers from each other). The JMLSG is therefore looking at the scope for increased reliance.

iv. The need for a more tailored approach for non-personal customers and wholesale business

61. Discussion of ID tends to focus on the treatment of retail, personal customers. ID is also required for non-personal customers such as corporates and trusts. The current Guidance Notes contain extensive provision for covering these cases. ID of non-personal customers normally involves confirming the identity not only of the entity that is the customer but of the individuals associated with the customer, such as shareholders, directors, beneficial owners and trustees.

62. Firms that have a predominantly non-personal customer base argue that current ID checks for non-personal customers are disproportionate, cumbersome and insufficiently risk-based.



63. The JMLSG is working with a group from the principal wholesale and institutional business trade associations to develop a revised regime in the light of experience and of a reconsideration of the aims and context of non-personal ID.

Communications

64. The Government recognises the need for the UK's AML strategy to be supported by an effective, collective communications strategy on ID and other elements of the AML regime. Such a strategy needs to promote adequate awareness and understanding not just among consumers (for which an essential part will continue to be communications by firms themselves) but also among other stakeholders, including staff in regulated firms and law enforcement officers. The Government welcomes the progress to date and will continue to work with partners and stakeholders to ensure effective communication.

Integrity of official ID tokens

65. One source of scepticism about the value of ID is the widely-expressed view that forgeries of official documents on which the ID regime depends, such as passports and driving licences, are readily available.
66. The Government has recognised the need to strengthen confidence in official documents - in the work of the relevant agencies to strengthen the integrity of passports and driving licences and facilitate access to their databases, and of the Home Office on identity fraud and on the introduction of a national identity cards regime.
67. This work is crucial to the simplification of ID – reliance on a single official document must depend on the adequate confidence of firms, and other stakeholders, in its integrity.
68. For non-personal customers, the industry has expressed a strong desire for a system of company registration that involves greater quality control of filed company documents than the present law presently envisages.

The FSA's supervisory approach

69. We recognise the existence of a 'fear factor'. It is important that the firms we regulate have a good understanding of how we see our financial crime objective and how we will pursue it, including through our supervisory and enforcement tools.
70. We will set out publicly our general approach to the use of our supervisory and enforcement tools, making it clear that, as already set out in our Enforcement Manual, we do not use these tools lightly.
71. Our current work to refine our risk assessment methodology (ARROW) for firms, and the revision by the JMLSG of its Guidance Notes, also provide a good opportunity for us to revise the guidance and training we give to our supervisors to ensure that we focus on the quality of firms' risk management arrangements – their assessment of their financial crime, including money laundering, risks and the actions they take to mitigate their material risks. At the same time, we will continue to expect high operational standards of firms, such as compliance with their obligations and their own policies and procedures, and good, accessible record-keeping, on ID as on other AML controls.



Annex A

Extract from Speech of 21 April on 'Anti-money laundering regulation – next generation developments' by Philip Robinson, Sector Leader, Financial Crime, FSA to City & Financial Conference

Identification

We all know that identification is a problem. Firms do not like getting ID from customers. Customers do not like having to provide it. Both read about the insecurity of standard ID documents and question their anti-money laundering value. The regime in general, and the FSA specifically, are perceived as too preoccupied with ID, and the voluntary review of current customers' ID being carried about by the major retail banks and others is criticised as unnecessary and costly.

There can be a funny side to this, such as the Oxford College required to produce its 15th century charter, complete with seal in order to open a new account. More often, it just seems mindlessly irritating, as it seemed for the senior colleague of mine trying to open an account for his daughter at a branch, only to be told (wrongly) that a council tax bill is not a utility bill!

Whatever the rights and wrongs, the present perception of the ID issue is very unhelpful and damages the support of the industry and their customers for the anti-money laundering effort.

We all have an interest in looking at the issue very seriously with a view to achieving a greater effectiveness, value for money and customer buy-in. But in doing so, we need to recognise some starting points.

First, identification is and will remain a legal obligation and international standard. It has been an obligation on Member States since the first EU Directive was adopted in June 1991. It has been an obligation in UK law since 1 April 1994. It is part of the revised FATF 40 Recommendations.

Second, identity information does contribute valuable intelligence to law enforcement for the investigation and prosecution of crime and terrorism whether the original information is true or false.

Third, ID fraud and theft are amongst the highest fraud concerns, of firms and of consumers. Witness all the reportage over the last year.

Fourth, the government has announced the introduction of ID cards on a phased basis commencing in 2007/8 on current plans, and is already taking steps to improve the security and integrity of existing official documents such as passports and driving licences. We and the industry are part of the Home Office's extensive consultative arrangements.

So, there is no point in talking about dropping ID requirements altogether. Nor is it fair to say that identification is pointless. The issues are rather - what are the most efficient and effective ways of dealing with ID? How can consumers be helped to feel that they are being asked to do something valuable and relevant and proportionate?



We need to get one important message across to the Consumer. By providing ID, they are helping in the fight against financial crime and terrorist finance. Nowadays, no one minds the inconvenience of security when boarding an aircraft, because they see the benefit to themselves and the other passengers of tight security. Being prepared to provide ID in financial transactions has the same benefit.

After all, society suffers from crime and terror and we are all part of society. We must all be prepared to provide valid ID, so that those who do not wish to do so can be more readily identified. After all, would you go on a plane if some of the passengers had refused to go through the metal detector but were still allowed to board the flight?

I know that identification is seen as a key topic in the revision of the JMLSG Guidance Notes. Within our present framework, that is the right place to deliver a new approach.

In that context, I would like to issue a joint challenge, to the Industry, law enforcement and consumer interests that we should work together to produce guidance on ID - and its application practice that:

- is risk-based – which therefore include clear differentiation between what is expected in lower risk situations and what is expected in high risk situations;
- is balanced – what is done for ID needs to take into account what is, or might be done, for monitoring and reporting – ID plays a role, but cannot bear the whole weight of anti-money laundering controls;
- imposes the least necessary burdens on consumers - not only should customers not be expected to provide the same level of identification; third party data sources should also be used to the fullest extent practicable;
- minimise the likelihood of disproportionate, inept application of ID at the counter or in the call centre. The industry must invest time and effort, and, yes, cost, in ‘the consumer experience’, looking at their internal guidance, training, support, systems and processes.
- provide for active education of customers in the reasons for ID and what may be expected of them. AML is for the benefit of consumers as citizens and as potential victims of identity theft or fraud;
- do not constrain access to financial services, for example, on the part of those without driving licences, passports or other documents. Industry practices have improved considerably in this in recent years.
- deal sensibly and sensitively with special groups for whom special processes may be appropriate - overseas students, ex-prisoners, asylum seekers, foreign workers etc... Again, industry practices have improved considerably, but continuing effort is needed.

Our joint aim should be that, by the end of 2005, we have between us defused the ID issue and effectively managed consumer expectations and the consumer experience.

I will bring together a broadly based group to look at the challenge and propose any solutions in time for the JMLSG re-write.



Annex B

List of organisations that have participated in the FSA's working group on anti-money laundering identification

Government and Law Enforcement

Assets Recovery Agency
City of London Police
HM Customs & Excise
HM Treasury
Home Office
Information Commissioner
Inland Revenue
Metropolitan Police Service
National Criminal Intelligence Service

Industry

Association of British Insurers
Association of Foreign Banks
Association of Friendly Societies
Association of Independent Financial Advisers
Association of Private Client Investment Managers & Stockbrokers
British Bankers' Association
Building Societies Association
CIFAS
Electronic Money Association
Finance & Leasing Association
Futures & Options Association
Investment Management Association
JMLSG
London Investment Banking Association
Barclays Bank
HSBC Bank
Jupiter Asset Management Ltd
Lloyds TSB Bank
Royal Bank of Scotland Group
UBS Investment Bank
West LB
Zurich Financial Services



Consumer Organisations

Business Action for the Homeless
National Consumer Council
UKCOSA – The Council for International Education

Credit Reference Agencies and other Service Providers

Callcredit plc
Experian
Equifax
GB Group plc

AML Consultants

Deloitte & Touche
Ernst & Young
KPMG
MHA Consulting
PricewaterhouseCoopers
RSMI Robson Rhodes

Other

Cass Business School

The following organisations also contributed to the work of the Group

Age Concern
Banking Code Standards Board
Citizens Advice Bureau
Department for Education and Skills
Department for Work and Pensions
Disability Rights Commission
Help the Aged
National Union of Students



Annex C - IDWG(04)9

Needs of stakeholders. Paper agreed by Identification working group

Individuals/citizens

- To be able to demonstrate adequately that they exist, and that they are who they say they are, in order to access financial products and services
- To be able to do so as easily and quickly as possible, with minimum duplication, effort and inconvenience
- To be able (as a minimum) to access basic financial products and services without being inappropriately constrained by identification requirements
- To have confidence that personal data is being used appropriately and in line with the Data Protection Act
- To understand the reasons for identity checks and how to satisfy them
- To have confidence in the effectiveness of identity checks in the fight against crime and terrorism

Non-personal customers (companies, trusts, charities etc.)

- To be able to demonstrate adequately that they exist, and that they are who they say they are, in order to access financial products and services
- To be able to demonstrate adequately who the individuals are that own/control the institution and that they are who they say they are
- To be able to do so as easily and quickly as possible, with minimum duplication, effort, and inconvenience
- To be able to do so in ways that do not inappropriately reduce international competitiveness
- To have confidence that personal data is being used appropriately and in line with the Data Protection Act
- To understand the reasons for identity checks and how to satisfy them
- To have confidence in the effectiveness of the checks in the fight against crime and terrorism

Regulated firms

- To be able to have reasonable confidence that customers are who they say they are



- To be able to use the results of checks to help manage their fraud, reputation and other business risks
- To be confident that, unless circumstances suggest otherwise, documents issued by official bodies can be relied upon for the purpose of identifying customers
- To be able to meet legal and regulatory requirements over fighting money laundering in a way which is cost-effective and proportionate to the risk
- To be clear what is required of them in law and expected by way of good practice in respect of the full range of situations where customer identification is required
- To be confident that the FSA's expectations of them in respect of identification of customers recognises, and reflects of an understanding of, the firms' risk-based approach
- For the checks required to be practical – so that the full range of customers (e.g. non-personal customers, overseas customers and those who are doing non face-to-face business) can be satisfactorily identified and appropriate documentation retained
- To be able to manage customer relationships, by being able to explain the reasons for and value of identity checks and to explain to customers the full range of ways in which they can demonstrate their identity
- For senior managers, MLROs, front-line staff and others in firms involved in fighting money laundering to understand the reasons for identity checks and to have confidence in the effectiveness of the checks in the fight against crime and terrorism

Law enforcement agencies

- To have access to up-to-date and reliable information about the identity of the holders and controllers of financial assets to support the detection, investigation and prosecution of crime and terrorism, with the information underpinned by a reliable evidential trail. The required assurance level for this information can be proportional to the perceived money laundering risk

Government

- To be able to demonstrate that the UK is meeting international legal obligations and best practice statements on anti-money laundering
- To be confident that ID systems strike the right balance between being proportionate and effective
- To be confident that identification systems do not detract from the international competitiveness of UK businesses
- To be confident that identification systems do not present a barrier to financial inclusion
- To reduce the amount of people that do not have access to a basic bank account

Financial Services Authority

- For the systems used by regulated businesses to be consistent with the risk-based approach that underpins the FSA's approach to fighting money laundering. The risk-based approach (which



inevitably means that identification checks will not be completely reliable in some low-risk cases) can then be reflected appropriately in the FSA's supervision and enforcement work

- For the systems to be consistent with the FSA's concerns about the needs of the customer
- For the requirements that the systems impose on the firms that the FSA regulates to be justifiable on a cost-benefit analysis

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