

# Money Laundering

*The monthly briefing service for anti-laundering specialists*

## bulletin

## The risk-based approach to AML: seizing the opportunity

By **Philip Robinson**, Financial Crime Sector Leader, FSA

In the last edition I wrote of the importance of firms and supervisors taking a more risk-based approach to fighting money laundering and terrorist financing. I now look in more depth at the anti-money laundering (AML) practice we at the FSA hope to see; and at some of the challenges facing AML practitioners in the private and public sectors as we all seek to turn the theory of the new approach into reality.

We have come a long way, and the industry in particular deserves great credit; but we have far to go before we can be confident that the costs and benefits of the regime stack up. We have a new and potentially effective framework – the right law, FSA Rules and industry (Joint Money Laundering Steering Group [JMLSG]) Guidance. To have more impact on crime, we must now push on with implementing a more risk-based approach to AML. And we must ensure we implement it well. Quality needs to be the hallmark of all we do.

### The FSA's contribution to delivering change

Through our Handbook, supervision and AML policies, the FSA has an important role to play in encouraging more risk-based and effective AML practice. We have radically revamped our Handbook provisions on money laundering and invested substantially in retraining our staff in how they should expect firms to manage their money laundering risks.

We look to firms to deliver:

- high AML standards, underpinned by sensible and discriminating use of the AML toolkit – ID, Know Your Customer (KYC), monitoring, training and reporting. Good 'basics' are the bedrock of effective AML, but how firms use them in practice may need to change. The tools are a means to the end of making life difficult for the criminal. To use them effectively a firm

needs to focus its efforts where the threats are greater and choose the right tools to reduce those threats – the best way to respond to a new high risk customer for example may be to do extra KYC and monitoring, rather than take extra ID;

- a risk management approach – to identify and mitigate risks; monitor, review and refine the effectiveness of the risk management systems; and to document the approach taken. We will expect firms to have formal AML policies, and effective ways to check those policies are working. There is no single blueprint, and a risk-based approach does not have to be complicated. In a larger firm, we would expect to see things like comprehensive documentation and active engagement by Internal Audit or Compliance Monitoring teams; in a smaller firm, the documentation and monitoring could be simpler. In all cases we will be looking for assurance that a firm is taking its obligations seriously and managing its risks well;
- clear senior management commitment. Under our new Handbook provisions there is now an explicit requirement for a firm to allocate to one or more specific directors or senior managers (who may or may not be the MLRO) overall responsibility for establishing effective AML systems and controls. We will expect to see demonstrable senior management engagement, underpinned by good flows of management information on a firm's outputs and use of tools;
- a strong MLRO. The MLRO is (and under our Handbook must be) the focus of AML activity in firms, and senior management must provide the MLRO with adequate resources and the independence to do the job effectively. The MLRO's professional expertise and judgement are more important than ever;
- systems and controls delivering at least as good risk management as outlined in the JMLSG Guidance.

Firms should have regard to the content of the Guidance in designing, implementing and monitoring their AML systems and controls; especially now the new Guidance is available free on the web. All firms should at least be aware of what the Guidance says, even if they then choose to deliver effective risk mitigation in other ways.

Firms' approaches to AML will become increasingly varied. Diversity is a natural consequence of firms acting in a more risk-based way and a successful AML approach is likely to be rooted in how a firm conducts the rest of its business – not something stand-alone.

Firms need to be confident about our expectations if they are to take full advantage of the new options. I have said many times, the driver for AML should be impact on crime, not regulatory risk. A risk-based regime is not a zero failure regime and our supervisory and enforcement approach recognise this. Public regulatory sanction should be a concern only for those not meeting their legal obligations or taking risk management seriously.

### 'Defusing the ID issue'

We want significant change in ID. When I launched our 'Defusing the ID issue' initiative in 2004 the aim was to help develop a regime that delivered more gain for law enforcement with less pain for the firm and honest customer. Parts of the ID regime were too formulaic, too inflexible, and at times brought the AML regime as a whole into disrepute.

The JMLSG's new Guidance is a huge contribution. The ID theory is now right. But, to turn the corner, we need to follow through in practice.

How we hope ID practices will change:

- in line with the JMLSG Guidance, firms will feel able to significantly decrease the number of documents needed to verify the identity of individuals and firms, particularly where money laundering risks are low. Checks need to be fit for their risk management purpose, and they need to be done well. Any additional 'gold plating' is a matter for the firm. The FSA is certainly not encouraging firms to go beyond what the risk demands;
- firms will see their principal objective as delivering quality in the checks and subsequent record-keeping. A check needs to give reasonable comfort as to the customer's identity and to generate a reliable record (with any photo reproduced clearly or any reference number accurately recorded);
- firms will take full advantage of a more streamlined approach over 'reliance' – where one regulated firm sometimes can depend on the ID checks of another, saving cost and inconvenience. We want firms to minimise the checks they carry out whenever they can without reducing the efficiency of their risk management. The risk-based approach is not principally intended to deliver cost savings, but 'reliance' is one area where it can;
- the greater flexibility firms now have over verification will mean that ID is no longer (and is not seen as) a significant barrier to financial inclusion;
- firms use ID checks to explain to the customer the value of AML. And to deliver a good 'customer experience' firms will inform potential customers about the full range of documents or other techniques acceptable as proof of ID;
- firms providing electronic verification services will continue to develop products so that users have information to assess the quality of the check and how much weight it can/not bear;
- the Government's strategy for tackling identity fraud will continue to yield AML dividends. The Identity and Passport Service has already made it more difficult to forge passports or obtain them in false names. And its new passport Validation Service enables accredited financial services and other businesses to check the validity and authenticity of passports. The Driver and Vehicle Licensing Agency has done similar work on driving licences, and Companies House has made its information more secure. These can all help firms make ID checks more reliable.

### Understanding the threats

The risk-based approach to AML is in its infancy. To reach maturity we need a much better understanding of what criminals do with their money.

How does a firm deepen its understanding?

- adopting an approach of continuous learning – by following the national and international publications or the media, and developing a good relationship with law enforcement. And, in an exciting development, an increasing number of firms are taking innovative initiatives to see what they can learn about risk from the SARs they make and the production orders served on them;
- from information provided by those supplying AML services to firms, such as the consultancies and software providers;

- by working with their peers and law enforcement, perhaps through their trade association, to build up the much better picture we all need on the threats that each sector faces;
- from law enforcement. The challenge is for the Serious Organised Crime Agency (SOCA) to identify what information is needed and how this can be provided. SOCA has given some exciting undertakings in the context of the Lander Review about building a closer relationship with the regulated sector and improving the flow of intelligence. They have our full support in following through on the report. We need, for example:
  - a better feel for what criminals are doing with their money. How much of the Government's estimated UK £25 billion per year of 'dirty money' being laundered in the UK is flowing through the financial services industry?
  - robust typologies and analyses of the risks associated with particular types of customer and product, developed in conjunction with the industry;
  - a better feel for firms out of step with their peers in terms of the number of SARs they make, lest the underlying reasons for this are a worry;
  - detailed intelligence on criminals' transaction behaviours, to allow firms and their service providers to build into their monitoring ways of looking for particular suspect patterns. With Missing Trader Intra-Community Fraud, for example, is all the information available factored into the monitoring procedures of those firms at highest laundering risk?
  - effective communication channels, such that information on the threats gets to all in the industry who should be using it.
- law enforcement find information such as National Insurance Numbers, telephone numbers, and copies of photographic ID of customers very helpful.

But we need more guidance on how to promote the quality of SARs. And firms have also made clear their need for better feedback. It is good to see SOCA rising to these challenges.

### Conclusion

There is much to be proud of about the UK's AML regime. But we need to build the momentum of change, to drive forward efforts to improve the quality of what we do, and to strengthen our partnership approach. I hope the coming months will see us all stepping up to the plate:

- the FSA supervising in a fully risk-based way;
- firms taking full advantage of new opportunities to shift their efforts to where the risks are greatest, confidently using their judgement, thinking creatively and being bold about how best to use ID and other AML tools;
- trade associations working on the challenges to them over supporting their members in changing their AML approach, including how they can help generate a clearer picture about the threat to their sector;
- law enforcement delivering the types of information on the threat that firms and regulator need, and helping firms understand what makes for a quality AML output;
- consultancies, software providers and the like making it easier for firms to use their AML tools in a more risk-based way.

And finally for us all, under the leadership of the Government, to identify and exploit the opportunities for working closer together to fight crime more effectively.

These sorts of issues should be on our AML agendas. I hope that this article will help stimulate a debate on how we can all deliver quality in our AML activities. We all have much to learn about how best to fight AML, and none of us has the right answers up our sleeves. We must work together better to help each other develop a new regime that makes life harder on the criminal. I am sure that *Money Laundering Bulletin* will be pleased to receive comments so that we can deepen debate on this most important subject.

---

*Any comments may be sent to the editor, Timon Molloy at email: [timon.molloy@informa.com](mailto:timon.molloy@informa.com)*

### Delivering what law enforcement need

We need to drive the AML regime forward through a relentless commitment to quality. This is a key challenge facing law enforcement and SOCA, for firms need a good understanding of law enforcement's needs to know how to judge the quality of their AML outputs.

Some needs are straightforward:

- firms should keep good records of ID and transactions, so there is good information on file in the event of an investigation into – say – terrorism;
- when making a SAR, a firm should concisely and clearly set out the who, why, what, when, where and how of the suspect activity; with the SAR being filed rapidly and in electronic form through one of the SOCA-preferred routes;